NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS Congressional Information Service
Washington, D.C.

S. Hrg. 101-126, Pt. 6

FEDERAL GOVERNMENT'S RELATIONSHIP WITH AMERICAN INDIANS

HEARINGS

BEFORE THE

SPECIAL COMMITTEE ON INVESTIGATIONS

OF THE

SELECT COMMITTEE ON INDIAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

NATURAL RESOURCES ON INDIAN LANDS

MAY 11, 1989
WASHINGTON, DC

PART 6

U.S. GOVERNMENT PRINTING OFFICE
21-286 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

★ (Star Print)

5411-33

SELECT COMMITTEE ON INDIAN AFFAIRS

DANIEL K. INOUYE, Hawaii, *Chairman*
JOHN McCAIN, Arizona, *Vice Chairman*

DENNIS DeCONCINI, Arizona
QUENTIN N. BURDICK, North Dakota
THOMAS A. DASCHLE, South Dakota
KENT CONRAD, North Dakota
HARRY REID, Nevada

FRANK. H. MURKOWSKI, Alaska
THAD COCHRAN, Mississippi
SLADE GORTON, Washington

ALAN R. PARKER, *Staff Director*
PATRICIA M. ZELL, *Chief Counsel*
ERIC EBERHARD, *Minority Staff Director/Counsel*

SPECIAL COMMITTEE ON INVESTIGATIONS

DENNIS DeCONCINI, Arizona, *Chairman*
JOHN McCAIN, Arizona, *Cochairman*
THOMAS A. DASCHLE, South Dakota

KENNETH M. BALLEN, *Chief Counsel*

CONTENTS

Statements: Page

Adams, George, auditor, Natural Resources Department, Northern Ute Tribe 17
Anderson, Karen, accountant, Energy Resources Division, Southern Ute Indian Tribe 3
Boyce, Brad, geologist, Energy Resources Division, Southern Ute Indian Tribe 3
Burch, Leonard, chairman, Southern Ute Tribe 2
Chavez, Ervin, Navajo, Bloomfield, NM 59
Cook, Marvin, director, Energy Resources Division, Southern Ute Indian Tribe 3
DeConcini, Hon. Dennis, U.S. Senator from Arizona, chairman, Special Committee on Investigations of the Select Committee on Indian Affairs. 1
Fetterolf, Randy, oil and gas expert, consultant, Special Committee on Investigations 33
Gover, Kevin, attorney, Wind River Tribes 24
Harr, Clarence, petroleum geologist, consultant, Southern Ute Indian Tribe 3
Jacobs, Eddie, president, Oklahoma Indian Minerals Owners' Association, member, Creek Nation Mineral Task Force 70
Norman, Charles, accountant, Special Committee on Investigation 50
Ortiz, Richard, director, Tax Commission, Wind River Tribes 24
Pettingill, Wes, director, Natural Resources Department, Northern Ute Tribe 17
Shipps, Tom, attorney, Southern Ute Indian Tribe 3
Taradash, Alan, attorney, Nordhaus, Halton, Taylor, Taradash and Frye, Albuquerque, NM 59

APPENDIX

Prepared statements:
Gover, Kevin 77

NATURAL RESOURCES ON INDIAN LANDS

THURSDAY, MAY 11, 1989

U.S. SENATE,
SELECT COMMITTEE ON INDIAN AFFAIRS,
SPECIAL COMMITTEE ON INVESTIGATIONS,
Washington, DC.

The special committee met, pursuant to notice, at 10:11 a.m., in room 628, Dirksen Senate Office Building, Hon. Dennis DeConcini (chairman of the special committee) presiding.

Present: Senators DeConcini and McCain.

Staff present: Kenneth Ballen, Andrew Klingenstein, and John Brandolino.

STATEMENT OF HON. DENNIS DeCONCINI, U.S. SENATOR FROM ARIZONA, CHAIRMAN, SPECIAL COMMITTEE ON INVESTIGATIONS OF THE SELECT COMMITTEE ON INDIAN AFFAIRS

Senator DECONCINI. The committee will come to order.

Senator McCain has been requested to attend a meeting at the White House and will be joining us later and has agreed that we go ahead and proceed because of our witnesses and what we need to accomplish today.

Before we start I want to make a brief statement.

Some people may want to minimize the problem of theft of oil and gas from American Indians. This committee certainly does not want to minimize the seriousness of the problem for Native Americans at all. Since 1980, less than 10 years, Indian royalties have totalled almost $1.2 billion. These committee hearings have clearly demonstrated without question that there has been no effective oversight by the Bureau of Land Management to prevent oil and gas theft on Indian land.

This committee has also found theft to be both a substantial and ingrained problem on Indian leases. In fact, of eight random lease sites surveilled and tested by the committee investigators, six were victimized by significant theft. Purchase theft is impossible to quantify, but when you have the largest purchasers of Indian oil in the country buying over $50 million annually from just one tribe of Indians and that company is stealing oil across the board, we think there is a serious problem.

We've found that these problems were not confined simply to one company or even one particular method of theft. When you take these activities and multiply them by the years of utter neglect, obviously you have a significant sum of money involved. The American Indians of this Nation are losing out because the Government has completely failed to protect their interest.

Let's put something in perspective. Questions may be raised about how many millions could be involved. Again, there is no way we can quantify how many millions are involved because we have no way of knowing the full extent of the problem. That is the job of the Department of the Interior, and their responsibility clearly has not been met. But to the American Indians of this Nation, who are the most impoverished group in the whole United States, these amounts are vital.

Later this week we'll hear from an Indian allottee who is homeless today. Let anyone who wishes to minimize the amount potentially lost to American Indians talk to her and to the other Native Americans that this committee has spent a substantial amount of time talking to.

This morning we are going to hear testimony from a panel of Native Americans: Thomas Shipps, Attorney for the Southern Ute Tribe; Marvin Cook, Director of Energy Resources, Natural Resource Department; Karen Anderson, Accountant, Natural Resource Department; Brad Boyce, Geologist, Natural Resource Department; Leonard Burch, Chairman of the Southern Ute Tribe; and Clarence L. Harr, Petroleum Geologist, Consultant to the Southern Ute Tribe. Mr. John Brandolino will do the questioning.

Would you all come forward, please, and take your seats.

[Witnesses sworn.]

Senator DECONCINI. Mr. Brandolino.

STATEMENT OF LEONARD BURCH, CHAIRMAN, SOUTHERN UTE TRIBE

Mr. BRANDOLINO. Chairman Burch, I understand you would like to open with some remarks.

Mr. BURCH. Yes, thank you. Mr. Chairman and members of the committee, we're honored to be here this morning to give our side of the story. My name is Leonard Burch and I'm the Chairman of the Southern Ute Tribe.

The Southern Ute Reservation which we occupy is located in the southwest part of the State of Colorado.

For many years our tribe has been mostly dependent on the revenues we receive from the production of natural resources on our reservation. Approximately one decade ago the tribal council decided that the Federal Government was not managing our natural resources in a satisfactory manner. We realized that we had no choice but to establish our own ability to monitor our resources. In 1980, we began the long process of forming a competent energy resource department. As Chairman of the Southern Ute Indian Tribe, I'm proud to appear before this committee today to say that we went with the right decision in actively managing the natural resources of our reservation.

Many challenges still await us but we have crossed many obstacles. Perhaps this committee and fellow tribes that depend on such resources on their reservation and the Federal agencies can learn from our experience. That is why we are here today. Thank you for the time and for giving me the opportunity to appear before you this morning.

I will turn it over to Mr. Shipps.

Mr. BRANDOLINO. Thank you very much. I understand this is a team effort and I know Mr. Shipps will be the primary spokesperson for the group.

STATEMENT OF TOM SHIPPS, ATTORNEY FOR THE SOUTHERN UTE INDIAN TRIBE, ACCOMPANIED BY MARVIN COOK, DIRECTOR ENERGY RESOURCES DIVISION, SOUTHERN UTE INDIAN TRIBE; KAREN ANDERSON, ACCOUNTANT, ENERGY RESOURCES DIVISION, SOUTHERN UTE INDIAN TRIBE: BRAD BOYCE, GEOLOGIST, ENERGY RESOURCES DIVISION, SOUTHERN UTE INDIAN TRIBE; AND CLARENCE L. HARR, PETROLEUM GEOLOGIST, CONSULTANT, SOUTHERN UTE INDIAN TRIBE

Mr. BRANDOLINO. Mr. Shipps, could you describe the natural resources that are found within the confines of the Southern Ute Reservation?

Mr. SHIPPS. The Southern Ute Indian Reservation contains substantial natural gas reserves. It also contains significant amounts of undeveloped coal reserves, and there is a limited amount of timber.

Mr. BRANDOLINO. What percentage of the tribe's revenue for the year 1988 was derived from natural resources?

Mr. SHIPPS. In 1988, revenues that were related to natural gas development amounted to approximately 94 percent of the revenue obtained by the tribe. In fact, if you were to go back the last decade, those figures have consistently run in excess of 90 percent of the tribe's revenue.

Mr. BRANDOLINO. What operations have been set up by the tribe to manage their resources and monitor royalties?

Mr. SHIPPS. As Chairman Burch indicated, approximately a decade ago the tribal council for the Southern Ute Indian Tribe determined that it was important to establish some kind of internal management group and created the Energy Resource Division at the tribe. That's been the primary effort.

Mr. BRANDOLINO. And how many tribal members are employed by this division?

Mr. SHIPPS. The division consists of 14 individuals, 6 of whom are tribal members, including Marvin Cook, who spoke to you yesterday, who is the director of the division.

Mr. BRANDOLINO. What types of duties are performed by this organization?

Mr. SHIPPS. The organization consists of five separate departments. Those duties depend upon which department you're referring to, but the scope of the duties includes everything from conducting land operations, which would be to ensure that the placement of natural gas wells doesn't interfere with agricultural operations; to make sure that environmental concerns are met; to preserve the archaeological and cultural resources of the tribe, on into oversight of royalty payments that are received by the tribe through the energy accounting department, and also a significant amount of the tribe's effort is spent in conducting minerals assessments and negotiating oil and gas agreements with different companies. It is very broad-based. It is a comprehensive division.

Mr. BRANDOLINO. What is involved with minerals assessment?

Mr. SHIPPS. Minerals assessment is really a critical aspect of what the department does. The tribe has an interest in approximately 900 wells located on the reservation. Going back to the early stages of the division, partly through the assistance of the Council of Energy Resource Tribes, the tribe embarked on a course of getting all the hard copy data, lease files and that type of thing related to historic production on the reservation, then they went through electronic drilling logs with respect to each of the wells that had been drilled on the reservation, conducted extensive cross-section analysis, including geologic mapping, and we now, with the assistance of the people that are here, have a computerized system so we can actually do computerized mapping of geological formations. It's a pretty extensive process.

Mr. BRANDOLINO. Has the tribe's work in this area benefitted the tribe financially?

Mr. SHIPPS. Without question it has.

Mr. BRANDOLINO. In what ways?

Mr. SHIPPS. With respect to minerals assessment, if you don't go through and assess what you have, it's kind of like the person who goes up to the attic and comes back the next Saturday and sells a Stradivarius at a garage sale, you just don't know what you have. We have several examples, one that comes to mind is a recent deal that we made with Ladd Petroleum Corporation, which is a major independent. As a result of sitting down with this particular company and negotiating with them, the tribe was able to obtain unique lease terms, including not only a royalty but also the opportunity to examine production from completed wells over a 220 day period of production, determine whether or not it wants to participate as a partner in those wells on a one-third basis. There really are literally dozens of examples.

Mr. BRANDOLINO. So the tribe, by knowing what bargaining chips it has, so to speak, is able to negotiate with industry and obtain favorable lease deals?

Mr. SHIPPS. No question. I think it is important to note that at this point we're actually developing the prospects internally and if we see a particular company that we like, we will go and approach that company. It is a very even, equal-handed, arms length process.

Mr. BRANDOLINO. Has the attitude of industry toward the tribe changed as your expertise has developed?

Mr. SHIPPS. It certainly has. I think that industry has been very grateful, quite frankly, for the tribe's efforts. We have found that our relationships with industry have improved considerably. Last year, in conjunction with the U.S. Geological Service and the Rocky Mountain Geologist Association, the tribe sponsored a scientific symposium on the development of fruitland methane coal reserves and we were pleased to have 300 people from industry and Government attend that conference. We had individuals from the Netherlands, from Australia. I think that industry has truly appreciated the ability of the tribe to proceed.

Brad Boyce just handed me a book, this is one of the books that was printed as a result of the symposium, it's really one of the foremost works right now on coalbed methane development.

Mr. BRANDOLINO. I understand that the tribe's expertise has even benefitted the Federal Government, the Minerals Management

Service, which is responsible for accounting for royalties and also auditing leases.

Mr. SHIPPS. It has. In fact, probably all three agencies that we've discussed. With respect to the Minerals Management Service, in the course of developing their computerized forms for supplying monthly production information, the tribe was able to convince Minerals Management Service that they should include in their format identification of geologic formations, that's been incorporated not only with respect to tribal lands, it's also been incorporated with respect to public lands.

We also on a regular basis work closely with the Bureau of Indian Affairs. The Bureau of Indian Affairs is very appreciative of the fact that they can come to the tribe and get technical support with respect to different items that are happening on the reservation.

Mr. BRANDOLINO. Moving off minerals assessment and development and getting back to functions that are carried out by the Minerals Management Service, which are royalty accounting and auditing of leases, has your tribe made any efforts in that area?

Mr. SHIPPS. The tribe approximately 4 years ago entered into a joint audit agreement with the Minerals Management Service.

Mr. BRANDOLINO. Could you explain briefly what a joint audit agreement is.

Mr. SHIPPS. Under the Federal Oil and Gas Royalty Management Act, the Secretary was encouraged to go ahead and work cooperatively with tribes in the course of conducting audits. So this audit agreement really is an outgrowth of that legislative directive.

Mr. BRANDOLINO. I understand you've also developed a system related to your severance tax that is issued by the tribe.

Mr. SHIPPS. In 1982, the Southern Ute Indian Tribe promulgated a severance tax. When a payor submits his payments to the tribe pursuant to that tax, accompanying that payment is significant information related to the production activity on the property.

Mr. BRANDOLINO. Mr. Shipps, do you see a need for tribes generally to get involved in these areas of mineral royalty accounting and royalty management?

Mr. SHIPPS. There is no question that the tribes need to get involved. Unfortunately, not all tribes are in a position where they can. But tribes need to do that if possible. I can think of several situations where reports that are submitted to MMS, quite frankly, that whole process kind of falls into a Bermuda Triangle between the BLM, MMS, and BIA. The tribe in one instance identified a situation only a couple of weeks ago where Mobil Oil Corporation had been holding leases for a number of years, valuable territory, the reports that had been submitted to the Minerals Management Service indicated that for an eight month period there had been no production on those properties. Within Minerals Management Service, that monthly report of zeros really means nothing to them. But for our purposes, the fact that there was zero production indicated that the leases had expired by their own terms. We worked cooperatively with the Bureau of Indian Affairs. Mobil has been notified that the leases are terminated, and we estimate that property alone probably has a conservative value of $10 million over the lifetime of the property.

Another instance I can think of is a situation where an operator was producing on property located on tribal lands, was submitting reports to the MMS indicating no production and it was only as a result of the tribe's efforts we were able to find out that this individual was not accurately reporting his royalties and the tribe was receiving no payment for that production.

Mr. BRANDOLINO. So the wells on the land were actually producing but the lessee was not reporting that production to the Minerals Management Service.

Mr. SHIPPS. That's correct. And the Minerals Management Service by itself really has no internal way to monitor whether those reports are accurate or not.

Mr. BRANDOLINO. How long did that continue?

Mr. SHIPPS. My recollection is that it had been occurring for a four or five year period. Excuse me, I've been told it was two years.

Mr. BRANDOLINO. Could you describe a little more about your system where you compare data received through your severance tax with data supplied to the tribe by the Minerals Management Service?

Mr. SHIPPS. Again, on a regular basis we do compare the production information that's submitted from the severance tax returns with the reports we receive from the Minerals Management Service and try and juxtapose those and make sure that they balance.

Mr. BRANDOLINO. Was that the system that was able to detect the fact that this particular lessee had not been reporting production but the wells had, in fact, producing?

Mr. SHIPPS. It was the system that was used to identify the Mobil situation. You'll probably have to call on Karen Anderson from the Energy Accounting. I'm not sure that system was used with respect to the reporting on the non-production or production.

Ms. ANDERSON. In both situations that Mr. Shipps described, the severance tax system was used to identify certain of those problems.

Mr. BRANDOLINO. Is it fair to say that had the tribe not had a severance tax in existence it would not be able to obtain the necessary documents from companies that provide this vital information that you're able to compare with information provided by MMS?

Mr. SHIPPS. That's true. We've been involved since the creation of the Minerals Management Service in trying to work with MMS and throughout the initial period we have found repeatedly reluctance from Minerals Management Service to distribute to us the actual hard copy data that is submitted by producers. So this is our only effective means to obtain that information.

Mr. BRANDOLINO. Through your efforts with this comparison system and through your efforts with the unfunded agreement you mentioned, the joint audit agreement, what sources of underpayments of royalties do you commonly find?

Mr. SHIPPS. I think that we have a number of concerns, many of those relate to the valuation policies that have been promulgated by the Minerals Management Service. Three that we've identified that are particularly troublesome include allowances, major portion analysis, and dual accounting.

Mr. BRANDOLINO. Could we go over those one at a time?

Mr. SHIPPS. This is going to be a little bit difficult. This is not the most romantic stuff in the world.

With respect to allowances, it is commonly understood in oil and gas industry, whether it is on public lands, tribal lands, or private lands, that there is an implied duty on the part of the oil company to extract the product from the ground, to process that product to put it into a marketable condition, then get the product to market. The costs of performing those tasks are not to be borne by the landowner, in fact, the royalty is supposed to be a cost-free interest. With respect to allowances, the Minerals Management Service has provided for transportation allowances, it has also provided for processing allowances, and most recently it circulated a new allowance which is called extraordinary processing allowances. We have in our more cynical moments thought that maybe the proposed extraordinary processing allowance was to help defray the costs of clean-up activities.

Mr. BRANDOLINO. When you mention allowances, let's explain a little bit about how that effects the royalty. When gas or oil is produced on the reservation, that product needs to be valued. Value is put on the product and then the tribe or the lessor receives a portion of that value as the royalty, is that correct?

Mr. SHIPPS. That's correct.

Mr. BRANDOLINO. So if deductions are taken, allowances, from the value, then the tribe's royalty decreases.

Mr. SHIPPS. That's correct. With respect to allowances, we're not only troubled by the fact that the allowances are being granted, if one assumes that MMS and the Secretary has discretion to go ahead and grant some of these allowances, we're also very troubled by the process which is used by MMS in permitting them to be taken. There is no pre-approval of the allowances. A company can go ahead and submit a statement claiming a transportation allowance and there is no initial oversight, so the only opportunity that you would possibly have to catch an allowance that's been unlawfully claimed would be on the tail end, on the audit. We have found—and perhaps we can discuss that some more, I'm sure we will— that we have grave concerns about the adequacy of the audit practices. So on the allowances, we're concerned not only with the fact they're given but also with the process that's used in permitting them to be taken.

Of the other issues I discuss, major portion analysis is a problem that is unique I think to tribal leases.

Mr. BRANDOLINO. And that leads to underpayments of royalties also?

Mr. SHIPPS. Yes, it does.

Mr. BRANDOLINO. could you explain briefly what major portion analysis is?

Mr. SHIPPS. I'll try. Pursuant to the 1938 Mineral Leasing Act, which is the act pursuant to which most of our leases have been issued, the Secretary has the discretion in making the value determination that you just mentioned, to either look at the wellhead price, the price that the seller or the oil company receives in selling the product at the wellhead, or in looking at the highest price paid or offered for a majority of like substances produced from the field or area. That's the majority portion analysis. We feel that the

Secretary in setting the value cannot effectively do that in anything but an arbitrary manner unless he goes ahead and actually does the majority portion analysis. Historically, the Federal Government has not conducted those majority portion analysis. We're very concerned about that and we feel that there has been significant historical underpayment with respect to tribal properties for failure to conduct the majority portion analysis.

Mr. BALLEN. Mr. Shipps, isn't that majority portion analysis required by law to be conducted?

Mr. SHIPPS. It is required by the lease terms, also I think it would be required by FOGRMA, but specially it was also mandated here as recently as a couple of years ago with the enactment of the NTL 5 Gas Royalty Act.

Mr. BALLEN. And it is not being done, is it?

Mr. SHIPPS. As far as we know, it is not being done anywhere.

Mr. BRANDOLINO. Okay. So majority pricing, allowances, and there was another category you mentioned.

Mr. SHIPPS. The third category was dual accounting. Again, this is a problem most applicable to tribal leases. An operator or an oil and gas company, when he takes the product from the tribal lease, if he processes that product and breaks it up into different components—for example, natural gas can be broken up into butane, propane, different other commodities—he is required to go ahead and pay royalty based upon either the net value of those frequently more expensive constituents, or upon the gross proceeds at the wellhead. Dual accounting is rarely, if ever, performed by operators and we have found significant reluctance on the part of the MMS to require that the dual accounting be performed.

Mr. BRANDOLINO. As with majority pricing, again it is a duty of the lessee when valuing a product to take the higher of two different prices to use that to value the product.

Mr. SHIPPS. That's correct.

Mr. BRANDOLINO. Which would increase the royalty that the tribe receives.

Mr. SHIPPS. It could increase.

Mr. BRANDOLINO. It could increase.

Mr. SHIPPS. And in fact, historically, would have increased. We feel convinced of that.

Mr. BRANDOLINO. And you feel that the companies may not be taking the higher of the two prices or making that comparison.

Mr. SHIPPS. That's correct.

Mr. BRANDOLINO. Ms. Anderson, as accountant for the tribe, I understand that you're the one who is actually involved with this joint audit agreement with the Minerals Management Service, you actually work with people from the Minerals Management Service to audit leases.

Ms. ANDERSON. That's true.

Mr. BRANDOLINO. Is the tribe able, outside the joint audit agreement, are they able to audit leases on their own and determine whether there are underpayments on their own leases?

Ms. ANDERSON. The tribe under its severance tax ordinance and under its own efforts look into problems and identify problems.

Mr. BRANDOLINO. And if it identifies problems or underpayments, is it able to enforce those underpayments?

Ms. ANDERSON. No. In all practicality that authority is vested in MMS to issue bills and collect royalties and penalties.

Mr. BRANDOLINO. So the tribe couldn't——

Ms. ANDERSON. I suppose that the tribe could go ahead and litigate to collect underpayments that the tribe has identified. But the expense and the time involved in litigation is pretty extensive.

Mr. BRANDOLINO. During your work with the Minerals Management Service, during the joint audit agreement, is MMS responsible for enforcing any findings made pursuant to that joint agreement?

Ms. ANDERSON. Yes, they are.

Mr. BRANDOLINO. When underpayments are identified, does the tribe collect those underpayments promptly?

Ms. ANDERSON. The MMS issues demands for collections and bills for collections promptly, generally. There have been cases however when companies have appealed those demands for collection. In two cases I can think of, the appeals were received by the MMS appeals division in 1986 and as far as I know they still sit unresolved at the appeals division at MMS.

Mr. BRANDOLINO. So these are two situations where audits were performed, underpayments were identified, the company appealed the decision that underpayments exist, that appeal was made to the Minerals Management Service and a decision has yet to be made in over two years by the Minerals Management Service?

Ms. ANDERSON. That's correct.

Mr. BRANDOLINO. Mr. Shipps, I know you're familiar with the joint audit agreement. Is the tribe able to determine what leases they will be able to audit when they perform an audit pursuant to this joint audit agreement with Minerals Management Service?

Mr. SHIPPS. In April of 1988, the Minerals Management Service issued its official royalty audit strategy. That strategy had been a document agreed upon by States, by tribes that were conducting audits or input from them to the Minerals Management Service. At that time we were assured that tribes would have the opportunity to assist in the selection of samples for audits, thereby ensuring that the tribal leases would be covered to some extent. We were also assured that should the tribe or a State feel that the sample was inadequate, the tribe or the State could notify MMS that it wanted to have its properties excluded from the audit and then could independently go back at a future date, in accordance with MMS work plans, and the tribe or the State could independently perform the audit to its satisfaction. This fall and this winter Minerals Management Service made some unilateral policy decisions which we feel exclude both tribes and States from the opportunity to guarantee that the samples that are being used are adequate. That process itself was very troublesome. There was apparently an ad hoc group from industry, consisting of 20 major companies, that were able to put pressure on MMS so compromises severly changing this audit strategy were rendered without any consultation with the tribes or with the States.

Mr. BRANDOLINO. So the Minerals Management Service basically made an agreement with industry that they would change the audit strategy that resulted previously from consultation with tribes and States and industry together.

Mr. SHIPPS. That's correct. With respect to your specific question about samples, it is important to know the philosophy MMS uses in conducting audits. MMS goes ahead and audits one company and in the course of conducting that audit, it is supposed to go ahead and pick up both what's happening on Federal public lands, what's happening on tribal lands, what's happening on allotted lands, offshore, on-shore, whatever, but they're going on a company-by-company basis. So when they take in that company, the issues that we raised earlier, for example, transportation allowances, major portion analysis, dual accounting—if, in the sample there is not included a representative group of your tribe's leases or your State's leases, those issues may be lost altogether. You may never have the opportunity once the audit is completed to go back and examine the records.

Mr. BRANDOLINO. In other words, the Minerals Management Service chooses a company and they do not audit every single lease that that company holds, they audit a sample of those leases.

Mr. SHIPPS. That's correct. In fact, the average that they use is, I believe, is 2 percent of the leases.

Mr. BRANDOLINO. You mention this unilateral change in audit strategy and you mention that it resulted in the tribe not being able to chose audit samples. What other concerns do you have with this change?

Mr. SHIPPS. There were a number of different of issues that resulted from the compromise with industry. One of the most significant ones is for the period between 1980 and 1983, with respect to all tribal lands as well as Federal lands, the audits for those time periods are to be closed this September. That's of grave concern to us.

Additionally, the period of time it takes to conduct an audit—and you can imagine if you're dealing with a major international company it may take some time—the agreement was made that audits would be closed one year from the date of commencement of the audit with respect to any of these companies.

Mr. BRANDOLINO. I understand the Minerals Management Service has also decided to hire outside contractors to perform additional audits that it may need.

Mr. SHIPPS. Approximately two weeks ago we were able to attend a meeting in Colorado where they had State and tribal auditors gathered. We were informed at that time that Minerals Management Service was at least examining and appeared to have made some internal decisions to contract out this whole process to third party audit companies or accountant companies. We're extremely concerned by that. The people like Karen Anderson, the people from States that are conducting these audits, are the people who know more about this issue perhaps than any single group in the United States. We're very, very concerned about that being shifted now to third party contract entities and we suspect that in itself is partly designed to minimize the continuing oversight that States and tribes are giving to this whole issue.

Mr. BRANDOLINO. Given that the tribe has a severance tax system in place, I'm sure you're familiar with the Supreme Court's recent decision in *Cotton Petroleum* v. *New Mexico*. Could you explain briefly what that decision holds?

Mr. SHIPPS. The Supreme Court ruled that there was presently no legislation pending that would preclude multiple taxation on tribal properties. An example of that, if the tribe, like the Southern Ute Indian Tribe, has its own severance tax, the Court upheld the notion that States can also tax the non-Indian company, or the operating company, that's conducting work within the reservation boundaries on the tribal property.

Mr. BRANDOLINO. So oil and gas companies that are producing on the Southern Ute Reservation will be subject to severance taxes from the State, maybe the county, and also the tribe.

Mr. SHIPPS. That's correct. In fact, last year Southern Ute estimated that the value of taxes recovered from reservation lands by tribes and States exceeded $2 million. The revenue the tribe received for its own severance tax was $1.8 million. So there are duplicative taxes that are now permitted on Indian reservation land.

Mr. BRANDOLINO. And the State is actually receiving more taxes from these companies than the tribe itself.

Mr. SHIPPS. It was in our situation.

Mr. BRANDOLINO. What other problems do you see this multiple taxation burden causing for the tribe?

Mr. SHIPPS. I think its important to follow that through. That ends up making the tribal property less competitive than property located off of reservations because you do have that duplicative tax and the operator has to compute that into his economics.

One of the issues that we're particularly concerned about is that in reaching its holding the court looked to the fact that the State of New Mexico had been regulating well spacing on the reservation territory and the Court felt that as a result of that regulation, there was a permissible level of taxation that could be imposed by the State. In the State of Colorado, we have repeatedly received statements from the State government indicating that they felt they were preempted from regulating the activities on Indian reservations. So we feel that the decision has the potential for substantially reducing the jurisdiction and sovereignty of tribes, and we feel that the decision will lead to repeated examples of jurisdictional battles between tribes and States with respect to the regulation of oil and gas activities, as well as other matters.

Mr. BRANDOLINO. So the *Cotton* decision actually encourages States to become more active in regulating within the reservation so that they can charge taxes?

Mr. SHIPPS. That's correct.

Mr. BRANDOLINO. Getting back to the tribe's accounting and auditing efforts. Ms. Anderson, has the tribe made any efforts, other than its efforts in obtaining this joint audit agreement, to obtain Federal assistance for its monitoring of royalties?

Ms. ANDERSON. Yes, it has. Two years ago the tribe applied for funding under Public Law 93-638, that's the Self-Determination Act, to expand and improve its joint audit program. We made application to the Bureau of Indian Affairs. The Bureau of Indian Affairs came back with a denial of our application claiming that while the Bureau did have authority to administer 638 funds, they did not have the authority to perform royalty audits. We subsequently made the same application to the Minerals Management Service and the Minerals Management Service denied our applica-

tion claiming that while they did have the authority to perform royalty audits, they did not have the authority to administer 638 contract funds. We felt, quite frankly, that we were engaged in a game of ping pong only the tribe was the ball.

Mr. BRANDOLINO. So you've yet to receive any money?

Ms. ANDERSON. We've not received any funding under our 638 application.

Mr. BRANDOLINO. The application has been rejected, has it not?

Ms. ANDERSON. By both agencies.

Mr. BRANDOLINO. Do you have any closing remarks, Mr. Shipps?

Mr. SHIPPS. Yes, I think in behalf of the tribe, the tribal representatives are pleased that we've had the opportunity to appear before you. The Southern Ute Tribe has really taken the initiative to try to maintain its own resources and manage those resources in a holistic fashion, not in a disjointed fashion. I think that we can demonstrate to the committee that those efforts have been very successful. We certainly hope that the committee will consider encouraging tribes to take a more active role in the future in this area. We hope that you consider also granting to tribes that demonstrate that effectiveness the tools that are necessary to go ahead and do that more effectively.

Thank you very much.

Mr. BRANDOLINO. I have no further questions.

Senator DECONCINI. Mr. Shipps, let me just get a couple of things clear for myself.

First of all, let me ask Chairman Burch, how many members are there in the Ute Tribe?

Mr. BURCH. We're a small tribe in comparison to the other big tribes. We number around 1,100 in all tribal members.

Senator DECONCINI. Do most of those live on the reservation?

Mr. BURCH. Most of them do, yes.

Senator DECONCINI. You or Mr. Shipps could answer this. About 94 percent of the budget of the tribe comes from natural resources income, is that accurate?

Mr. SHIPPS. That's correct.

Senator DECONCINI. Does that include any Federal funds through the BIA in your budget?

Mr. SHIPPS. No, the funds that I'm talking about are really royalty or bonus money or something derived——

Senator DECONCINI. Outside income, we call it.

Mr. SHIPPS. That's correct.

Senator DECONCINI. Is it a confidential matter as to the range of that amount of money? If it is, you can tell me later. I don't need to know for the record necessarily, but I'm just interested in knowing what kind of money we're talking about here.

Mr. SHIPPS. We prefer to talk to you about that later.

Senator DECONCINI. All the operating expenses for this is paid out of these monies?

Mr. SHIPPS. That's correct. Although we have received some success in getting some grant money under 638, not so much for the audit practice, but Mr. Boyce, perhaps if you want more details about that, could describe what has happened.

Senator DECONCINI. Mr. Boyce?

Mr. BOYCE. We applied a couple of years ago for some 638 mineral assessment funding. We were successful in getting that. That helped us hire some outside assistance in understanding what we had in the ground. We also had an agreement through the BIA Energy and Minerals Office in funnelling money into the U.S. Geological Survey to do mineral assessments. That, in conjunction with our work and the 638 funding, really gave us a great resource base to work from. However, some of that funding has been recently discontinued.

Senator DECONCINI. When did you start receiving 638 funding?

Mr. BOYCE. Three years ago, I believe.

Senator DECONCINI. And are you still getting any of it now?

Mr. BOYCE. Yes. We just recently received this year's funding, we got notice the other day and we applied for it almost a year ago for this year.

Senator DECONCINI. That funding represents how much of the administrative costs of what you do to monitor this? Let me put it another way. What amount of money does the tribe spend out of your budget on this auditing process and all that you do? Can you give me a ball park figure?

Mr. BOYCE. I'd say approximately $400,000 a year. We keep the mineral assessment funding separate from the administration funding of our office. It is earmarked specifically for mineral assessments and inventory on the reservation.

Senator DECONCINI. Was the figure that you used, Mr. Shipps, for administering?

Mr. SHIPPS. The figure that I used would be the total amount that is spent by the tribe on an annual basis.

Senator DECONCINI. Total amount.

Mr. SHIPPS. And that's for administration.

Senator DECONCINI. And then on top of that you get some money from 638.

Mr. BOYCE. Correct.

Senator DECONCINI. So you've made a tremendous commitment there to monitor this, obviously. Have you done any analysis of what you have been able to recover? In essence show that there have been mistakes and been able to increase your income as a result of this?

Mr. SHIPPS. Let me just say that this happens on a daily basis. We don't have the time to go back through and just make the issue accountable. Brad may have a figure, but it's been tens of millions of dollars.

Mr. BOYCE. I don't have a figure but a good example is that when the oil industry took a severe hit here just a couple years ago, because of the efforts of the Southern Ute Indian Tribal Council and I believe the efforts of the Energy Office, the Southern Ute Indian Tribe did not take a severe hit in their economics.

Senator DECONCINI. You're talking about when the price came down, you stepped up your auditing and reviewing and whatever and you found that you weren't getting the full amount——

Mr. BOYCE. It was a combination of all of the above. Negotiating deals with industry to establish new income——

Senator DECONCINI. Renegotiations and that sort of thing?

Mr. BOYCE. Correct.

Mr. SHIPPS. Senator, I think it is important and one of the reasons why we are here is we think that philosophically, if a tribal council or tribal government can come to the Energy Division and say we project we're going to need X amount of revenue next year to operate our government effectively, and then go and say, okay, go after it. If we can go ahead and do a total kind of picture, where we're actually managing the resource to generate the revenue that's necessary for governmental operations, and pick up areas where we need to pick up areas to generate that revenue so the resource actually becomes a tool and a management tool for the tribe to continue to operate. And it has been disjointed in the past.

Senator DECONCINI. In order to do what you're doing, you have to have this joint audit agreement with the MMS. Does the BIA have to approve that? I'm trying to figure out how you get into this position that you're in, where you can do the auditing and reviewing.

Mr. SHIPPS. Again, it depends upon what we're talking about. With respect to the joint audit agreement, that's an agreement that has to be approved by the Minerals Management Service and the tribal council. The operations of that agreement are subject to departmental policies that come out of the Minerals Management Service, including reductions now on samples, that type of thing.

With respect to entering into negotiations with oil companies, to go ahead and enter into new lease contracts or minerals agreements, that has to be approved ultimately by the Bureau of Indian Affairs.

Senator DECONCINI. So if you go to an oil company, you see the oil prices dropping or gas prices dropping and you want to renegotiate, you can go directly to them but anything you do has to be approved by the BIA?

Mr. SHIPPS. That's correct. Or another situation, if on a particular property we don't think that the operator is adequately developing the property, we would go to that company, and this has happened, go to the company and identify a drainage situation and through the work of the geologist, they have gone to the company, said this is an ideal spot to drill this particular well, we think that if you drill the well here it is going to generate revenue, and the company was very reluctant at first to go ahead and do that, but drilled the well and it's a record-breaking well for that formation. I think that's the type of thing that has increased our credibility with industry and also increased revenue.

Senator DECONCINI. What about the negotiations? If you negotiate with a company yourself as the tribe, or the Energy Department on behalf of the Tribe, and you decide on a royalty and you write up the agreement and you have the cancellation clauses and renegotiation clauses and attorneys fees clauses and everything else, then you present that to the BIA, is that when they get in or are they in at the initial negotiations?

Mr. SHIPPS. If the tribal council wanted to approve it or disapprove it, if the council say, yes, we're for that, we would then go to the Bureau of Indian Affairs after having obtained the appropriate signatures. The Bureau of Indian Affairs statutorily has the obligation to review that and either approve or disapprove it.

Senator DECONCINI. How much involvement does the BIA get in approving that? Do they get into the renegotiations? Do they suggest that you not do this or that you change this, or do they either say yes or no?

Mr. SHIPPS. No. The Bureau of Indian Affairs has very limited involvement with respect to the negotiations. We have been very lucky at the Southern Ute Indian Reservation in terms of having at least a local agency, Southern Ute Agency, that has wanted to work closely with the tribe. So we will then go through and discuss this matter with the Bureau of Indian Affairs, but I think the Bureau of Indian Affairs is quite confident in most instances that we've done our homework before we take it to them.

Senator DECONCINI. Turning to the MMS and the joint audit agreement, when they set these three things that you talked about—the allowances, the dual accounting, and the major portion analysis—do you have any appeal when you do go back and audit this and find that they allowed what you consider an excessive transportation allowance? First of all, is there an industry standard for such allowances?

Mr. SHIPPS. Yes, there is, Senator.

Senator DECONCINI. If MMS allows such an allowance that is above the industry standard, or even if it isn't, do you have any rights to contest that?

Mr. SHIPPS. We're going through the process right now and testing that to see whether or not we do. We recently filed an appeal with the Minerals Management Service. But it is difficult because within the context of conducting the audit, our auditor is bound by the policies of MMS, so it is difficult and uncertain precisely what appellate rights we have. In fact, I was informed by several of the representatives from Minerals Management Service that they doubted whether we had the right to appeal at all. I suppose that you might be able to have the opportunity when the audit was closed to go back after the fact and file a law suit claiming that the audit had been improperly conducted. But it is just a ridiculous process.

Senator DECONCINI. All very expensive, too.

Mr. SHIPPS. That's correct.

Senator DECONCINI. Can you give me an estimate, anybody, what do you think conservatively that your Energy Department and your own tribal efforts to audit have meant in revenues to the tribe that you would not have received had you not been in this business of doing that?

Ms. ANDERSON. Under the joint audit agreement, which has been in place for approximately four or five years——

Senator DECONCINI. Okay, let's take that period of time.

Ms. ANDERSON. We have completed three audits and we have three audits on-going right now. As I told you earlier, two of those audits have been appealed and the significant portion of our findings are currently under appeal since 1986. Those two appealed audits total in royalty findings combined in excess of $500,000, closer to $600,000——

Senator DECONCINI. That's additional funds?

Ms. ANDERSON. That's additional funds and that is without interest included, so that is just royalty findings. With interest included, it would be closer to $1 million.

Senator DECONCINI. In addition to that, have you also been able to get the oil companies or gas companies, what have you, to voluntarily increase their payments without going through the whole audit? Or does it always take this process of having to go through the formal audit?

Ms. ANDERSON. It is possible to identify a problem that is not considered appealable by the company and we have received collections on unappealed findings. I might add that an important part of the auditing process is not just collections but proper reporting and accurate reporting. That's extremely important to the tribe.

Mr. SHIPPS. Senator, if I could. We have identified as a result of Karen's work at least one particular issue which is related to NTL–5, where the tribe has estimated that we had been underpaid prior to the legislation that was passed several years ago, we had been underpaid in excess of $7.6 million.

Senator DECONCINI. Over what period of time?

Mr. SHIPPS. Over the period between 1982 and 1986. A compromise was reached legislatively in U.S. Congress with respect to that particular issue that requires the Secretary to perform the major portion analysis that I described earlier to reach settlement with all the tribes. Again, those major portion analyses are not being performed. So, it is difficult for us to say precisely how much money, while we can say how much we've recovered, we can tell you how much is pending, and some of it is not being followed through with.

Also I think there is a substantial amount of revenue that is generated from taking a constant vigilant approach so the companies comply with the laws. If they know you're watching, most companies, quite frankly, we have found to be very good operators. We are not terribly upset with the industry. We enjoy our relationships. We have made efforts to kick off the bad operators. And I think the companies will go ahead and comply with the law if they know that you're watching.

Senator DECONCINI. I think that the answer to this question is obvious, but you do believe that if you relied just on the MMS and other agencies to audit and review this that you would be in safe hands?

Mr. SHIPPS. Absolutely not.

Senator DECONCINI. Is that due to, in your opinion, lack of commitment, competence, or personnel and resources, or would you say all?

Mr. SHIPPS. No. With respect to MMS, as a group, there are probably located in MMS more individuals who are committed to doing a good job, who are intelligent people, but I think they get caught in a bind that we're not necessarily concerned with. They are subject to tremendous pressure, both from tribes and from States as well as from industry, and as a result, many of the policies have to go through changes that end up softening what we think is their responsibility. We're not quite so troubled by that, so I think that we can perform a more effective role.

Senator DECONCINI. Not to put words in your mouth, but you think there are very competent experts there but because of the operation of MMS, its policy implementation is not in the best interest of you and other Native Americans, is that fair?

Mr. SHIPPS. That's correct.

Senator DECONCINI. Okay. Do you have any further questions?

[No response.]

Senator DECONCINI. Thank you very much. Your testimony is very helpful to us. We appreciate your being here.

Mr. SHIPPS. Thank you.

Senator DECONCINI. Next we will hear from Wes Pettingill, Director of Natural Resources Department; and George Adams, Auditor, Natural Resources Department. They are with the Northern Ute Tribe in Utah.

Gentlemen, would you come and be sworn.

[Witnesses sworn.]

Senator DECONCINI. Mr. Brandolino.

STATEMENT OF WES PETTINGILL, DIRECTOR, NATURAL RESOURCES DEPARTMENT, NORTHERN UTE TRIBE, ACCOMPANIED BY GEORGE ADAMS, AUDITOR, NATURAL RESOURCES DEPARTMENT, NORTHERN UTE TRIBE

Mr. BRANDOLINO. Could each of you just introduce yourself and reveal your titles.

Mr. ADAMS. Mr. Chairman and members of the committee, my name is George Adams. I am auditor for the Northern Ute Indian Tribe.

Mr. PETTINGILL. Mr. Chairman and members of the committee, my name is Wesley Pettingill and I'm the Director of Natural Resources of Energy and Minerals for the Northern Ute Indian Tribe of the Uintah and Ouray Indian Reservation. Under that position, I am also the acting severance tax director for, hopefully, not too much longer.

Mr. BRANDOLINO. Mr. Pettingill, what natural resources are found within the Northern Ute Reservation?

Mr. PETTINGILL. The reservation contains a number of natural resources, the most significant by far are the oil and gas reserves. There are also considerable amounts of tar sands and oil shale deposits. Then there are some minor deposits of metallic and non-metallic minerals, such as gold, copper, and some phosphates, none of which are very commercial. By far the most important ones, of which the tribe derives the majority of its revenue, are the oil and gas reserves.

Mr. BRANDOLINO. How many leases currently has the tribe entered into?

Mr. PETTINGILL. The tribe has been into oil and gas leases probably about the last 30 years and there has been in excess of 5,000 leases issued. Not all those are current nor are they active now. Currently there are 550 actively producing oil and gas leases.

Mr. BRANDOLINO. How much in royalty payments did the tribe receive in 1988?

Mr. PETTINGILL. While I'm not totally at liberty to reveal the exact amount, it is in excess of $5.5 million.

Mr. BRANDOLINO. Could you describe briefly the organization set up by the tribe to manage its royalties?

Mr. PETTINGILL. Much like the Southern Utes, the Northern Utes initiated their concern for the management of resources approximately 10 years ago in 1976. It went merrily on its way, not really going very far until the early 1980s, during the oil and gas boon that occurred from about 1980 through 1985, the Department really grew and became very important to the tribe.

Since 1986, the tribe has taken an emphasis on really managing the resources to maximize and maintain the level of revenue insofar as they can.

Mr. BRANDOLINO. Has the tribe initiated a severance tax recently to collect more revenues?

Mr. PETTINGILL. Yes. The tribe initiated a severance tax commencing on November 1, 1988. That is one of the departments that's in the Energy and Minerals Department I meant to touch on earlier. The Energy and Minerals Department has four sections. Those sections consist of the oil and gas development portion and then we have our well site and lease monitoring section, we have a royalty management and audit section, of which Mr. Adams heads that up, then we have our severance tax department.

Mr. BRANDOLINO. Have you initiated a system similar to the Southern Ute to collect source data from industry pursuant to your severance tax and compare that data with the data you receive from the Minerals Management Service?

Mr. PETTINGILL. Prior to the enactment of the severance tax, we had made several attempts to receive the information that we felt was very critical to the efficient and proper management of the resources. A number of times we would ask through the BIA, BLM, MMS if we would be able to receive copies of what we call the reporting forms that the oil producers submit to the MMS and to BLM, and those are the 31-60s, which is a form that provides the gross production data from any particular lease. Then the form 20-14, which is the disposition of that product, what it was sold for, where it was sold, etc.

Prior to the enactment of the severance tax, we were unable to get all of this information. Some companies were cooperative and sent it to us directly. As far as getting these reports directly from the BIA, BLM, or MMS, all three were receiving copies of it, we were unable to do that.

Mr. BRANDOLINO. As a result of the tribe issuing a severance tax, you were able to require that companies send you these documents directly?

Mr. PETTINGILL. That is correct. Under part of the regulations of the severance tax is that these forms and a quarterly form similar to them are submitted to the severance tax department on a monthly basis.

Mr. BRANDOLINO. Was the tribe able to use the information provided by the Minerals Management Service and the Bureau of Indian Affairs before it initiated severance tax?

Mr. PETTINGILL. On a limited basis, yes. To the extent that some gross values, revenues that supposedly had been paid and were available as to what was coming in, but as far as trying to utilize the information on a current basis, it was impossible to use because

most of the MMS information submitted to the tribe was at least three months old.

Mr. BRANDOLINO. Mr. Adams, as the auditor and accountant for the tribe, I'll propose that question to you. Did you think that the information provided by the Minerals Management Service and the Bureau of Indian Affairs is adequate in itself to assist tribes in monitoring their own resources.

Mr. ADAMS. I have a very difficult time with some of the reports that come out of Minerals Management Service. They are very sketchy reports, there are very sketchy definitions of what these reports consist of and what they mean. I think with the severance tax program we have in place now, the Northern Ute Tribe is in a much better position to be able to interpret reports, receive reports from companies, and to manage its own affairs.

Mr. BRANDOLINO. Have you seen instances where information you've received from the agencies has just been indecipherable?

Mr. ADAMS. Almost to that point, yes. If you call MMS, you would not receive satisfactory explanations of what the report consisted of.

Mr. BRANDOLINO. Did you recently receive information that one company was claiming recoupment for some royalty payments made 12 years ago.

Mr. ADAMS. That's very true. Hopefully, we'll touch upon this again later in this discussion. But I would like to point out here and now that receiving that report from this company requesting recoupment from 12 years ago certainly belies their arguments of the fact that they have record retention of only 6 years.

Mr. BRANDOLINO. How long have you been auditor for the Northern Ute Tribe?

Mr. ADAMS. I've been with the Northern Utes approximately 15 months as an auditor.

Mr. BRANDOLINO. What was your experience? Had you worked with any other tribes before then?

Mr. ADAMS. Yes, I was with the Navajos as auditor general for approximately six and a half years.

Mr. BRANDOLINO. In your capacity as auditor for the Northern Ute Tribe, have you been involved with any audits of leases?

Mr. ADAMS. Yes.

Mr. BRANDOLINO. What system does the tribe have in place where it can be able to assist in the auditing functions that are routinely provided by the Minerals Management Service?

Mr. ADAMS. We at the present time are one of two tribes that has a 202 contract with Minerals Management Service.

Mr. BRANDOLINO. Could you explain briefly what a 202 agreement is and is that different from the agreement the Southern Utes had. They had a joint audit agreement.

Mr. ADAMS. Yes, it is different. A 202 contract that we currently are operating with MMS on is that we put up 50 percent of the funding for the audit activity, MMS puts up 50 percent of the funding for the activity. Either through the 202 contract or memorandum of understanding or delegation of authority are the only three ways that a tribe can audit its mineral leases.

Mr. BRANDOLINO. So had you not entered into this 202 agreement or not had authority from MMS to perform audits, the tribe would not be able to perform audits?

Mr. ADAMS. That's correct.

Mr. BRANDOLINO. So you have not conducted any audits independently of Minerals Management Service?

Mr. ADAMS. No Indian tribe has the authority to conduct audits independent of Minerals Management Service. Last year, while we were waiting to put our 202 contract in place, we set up a memorandum of understanding and we conducted three audits last year working with Minerals Management Service. Our 202 contract became effective October 1, 1988. Since that time I have been conducting my own audits.

Mr. BRANDOLINO. And how many tribes have these 202 agreements?

Mr. ADAMS. Two.

Mr. BRANDOLINO. Only two?

Mr. ADAMS. Yes.

Mr. BRANDOLINO. Who is the other tribe?

Mr. ADAMS. The Navajo Tribe.

Mr. BRANDOLINO. Is it common for audits to uncover underpayments?

Mr. ADAMS. Yes, it is.

Mr. BRANDOLINO. Could you safely say that every audit may lead to findings of underpayments?

Mr. ADAMS. I think I could safely say that better than 95 percent of all audits will uncover some type of underpayment.

Mr. BRANDOLINO. What are the sources of underpayment that you commonly have found?

Mr. ADAMS. Some of the sources of underpayments are improper evaluation of product, improper transportation allowances, improper gathering allowances, improper manufacturing allowances, improper processing allowances for sulphur, not reporting or paying royalties on new production as the result of a new well coming on stream for the first 2 or 3 months, majority pricing not done, lack of dual accounting. Those are just some.

Mr. BRANDOLINO. Do those reflect the sources mentioned by the Southern Ute Tribe? A lot of them are similar.

Mr. ADAMS. Very similar, yes.

Mr. BRANDOLINO. They involve the evaluation of gas, do they not?

Mr. ADAMS. The majority of the findings involve gas. It has been my experience, and I think the experience of most other groups, that oil is fairly clean.

Mr. BRANDOLINO. Once an audit is concluded, does the tribe enforce the audit findings?

Mr. ADAMS. That's a responsibility of MMS.

Mr. BRANDOLINO. So the tribe is unable to enforce it?

Mr. ADAMS. That's right. We can take the audit up through drafting of a finding letter, which goes to MMS for final editing and issue. And the appeals process is managed by MMS.

Mr. BRANDOLINO. Even though you have this special 202 agreement, still the Minerals Management Service is ultimately exclusively the one that will enforce audit findings?

Mr. ADAMS. That's correct.

Mr. BRANDOLINO. Mr. Shipps had commented on the unilateral change in audit strategy made by the Minerals Management Service. He said the Southern Ute Tribe had concerns with that. Do you share their concern? Maybe you can elaborate on that.

Mr. ADAMS. I have some very grave concerns considering the current minerals management audit strategy, starting with their audit closure policy. I'll give you a specific example of what I'm talking about. I agreed to work with MMS on a joint audit involving Chevron USA in order to catch up their back audits for that company. We were reviewing the period from fiscal years 1981 to 1983. I selected 22 leases out of a population of 144 that I wanted to review in my audit process. Prior to my commitment to participate in this audit, they had selected three leases and after I put in considerable amount of effort pulling records and so forth, I found out that I was going to be held to those three leases. Now that means that out of a population of 144 leases, I'm going to look at 2 percent or less. The 22 leases that I had selected were high producers and because of this audit closure policy, I will not be able to look at those other 141 leases after completing the review of these three. I take strong objection to that.

Mr. BRANDOLINO. The Minerals Management Service in this change requires now that all audits for the periods 1981 through 1983 be finished by September of this year and that come the end of September this year, those periods are closed for audit forever.

Mr. ADAMS. That's correct. I'd also like to point out, we're being shut out of auditing these leases—referring back to your example a few minutes ago, you have a company coming back in after 12 years and requesting refunds, I think it is totally unfair. If we're going to be shut off, then they should not be allowed to request recoupment or refunds or whatever.

Mr. BRANDOLINO. So recoupment is just a company coming back at a later period and saying we paid you too much, we want to take some back?

Mr. ADAMS. That's correct. Something to that effect.

Mr. BRANDOLINO. Do you have any other problems with the change in audit strategy?

Mr. ADAMS. Yes, sir. The Southern Utes referred to it as well, but they've come up with a policy whereby we have to complete an audit in one year from the time we start. That's just totally unrealistic. There are too many unknowns that we have no control over to be able to complete an audit in one year. For example, on this Chevron audit, I started requesting records the latter part of last November and to date I have not received more than one-third of what I asked for, and that's four months ago. So, conceivably, under this new policy, a company could stonewall you until midnight of September 30th and you would never complete an audit.

Mr. BRANDOLINO. Mr. Pettingill, Mr. Shipps discussed the Supreme Court's recent decision in *Cotton Petroleum* v. *New Mexico,* which allows multiple taxation on reservations. He mentioned that the Southern Utes had concerns that this would mean a loss of revenue for the tribe for a number of reasons. Does your tribe share these same concerns?

Mr. PETTINGILL. Yes, it does. The problem with the double taxation, as Mr. Shipps explained, is that it just adds another burden to the producer for arriving at the bottom line profit, and that's what they are there for. At Northern Ute, we'd only really anticipate a significant short term problem, by short term I mean one to two years. Currently the producers that are there probably are going to be able to maintain the existing production carrying a double taxation burden. What we're not going to see long term is the addition of new reserves to the reservation and the development of any new reserves.

Mr. BRANDOLINO. Have companies intimated to you that this multiple taxation burden may hinder development?

Mr. PETTINGILL. Yes, they've been saying that all along. Some of it is real, some of it is rhetoric.

Mr. BRANDOLINO. Thank you very much. Do you have any closing statements?

Mr. PETTINGILL. What I would like to bring up are some things that George has touch on. We need stronger abilities to take more control for the tribe. The tribes need to look after their own interest. It is their interest that needs to be protected and no one protects your interest better than yourself, no matter how well intentioned they are.

I think MMS has some good intentions of trying to help the tribes but they're so caught up in their own system, their own regulations, that the best interest of the Ute Tribe and the Southern Utes, the Shoshones, the Arapahos, all the tribes that have natural resources, are secondary in nature.

Mr. BRANDOLINO. Thank you very much. Thanks for coming today.

Mr. PETTINGILL. Thank you.

Senator DECONCINI. Gentlemen, thank you. I have no questions. I appreciate your testimony and I do want to just make a comment, or maybe you can just put this on the record.

How long have you been with the Northern Utes, Mr. Adams?

Mr. ADAMS. Senator, I've been with the Northern Utes approximately 15 months.

Senator DECONCINI. And before that?

Mr. ADAMS. Before that I was the auditor general for the Navajo tribe for approximately six and a half years.

Senator DECONCINI. So you've had experience in this auditing business for some time?

Mr. ADAMS. My auditing background covers approximately 22 years, sir.

Senator DECONCINI. And how many years of that has been with Native Americans?

Mr. ADAMS. Almost 8 years.

Senator DECONCINI. You were involved in the auditing that brought about the Koch oil discoveries problems?

Mr. ADAMS. No, sir, I was not involved in that investigation. But we completed an audit at Koch last December; that was one of the three audits that I worked on last year with MMS under a memorandum of understanding. We had some substantial findings there, sir. I don't know the exact number yet, but their hands were dirty.

Senator DECONCINI. When will that be completed?

Mr. ADAMS. The issue letter should be out now. I spoke with MMS last week and the person I needed to discuss it with was out of the office.

Senator DECONCINI. Can you comment? You say you found substantial——

Mr. ADAMS. The sum is substantial.

Senator DECONCINI. You're talking about substantial losses to the Indians?

Mr. ADAMS. Substantial loss of royalty revenue to the Ute tribe.

Senator DECONCINI. To the Ute tribe as a result of Koch Oil Company?

Mr. ADAMS. As a result of their misuse of allowances that I ticked off a couple of minutes ago.

Senator DECONCINI. Okay. I just wanted to be sure. Thank you very much.

Mr. Ballen has a question.

Mr. BALLEN. That's in addition to the theft? I don't know whether you heard the committee's hearings earlier this week what the committee discovered in our surveillance—and we will forward a record of that to you.

Mr. ADAMS. The findings I'm referring to are independent of your investigation.

Mr. BALLEN. Thank you, sir.

Mr. PETTINGILL. Mr. Chairman, may I just add something?

Senator DECONCINI. Yes, Mr. Pettingill.

Mr. PETTINGILL. Of the theft that we see on Indian reservations, 90 percent of it is legal theft.

Senator DECONCINI. Define that for me.

Mr. PETTINGILL. Due to the transportation allowances, processing allowances, manufacturing allowances, the myriad of allowances that the producers are able to take and deduct from the 100 percent of the revenue received prior to paying royalties.

Senator DECONCINI. You're seeing that on your reservation?

Mr. PETTINGILL. On our reservation, yes.

Senator DECONCINI. Now, you don't know whether that's true of all Indian country?

Mr. PETTINGILL. I can only surmise that perhaps partly is true in that while we do have unique problems, they are not totally unique.

Senator DECONCINI. Because we found in our investigation here that reporting long numbers is a substantial loss to Indians, I don't know what percent it is because we only reviewed 30 companies. Will your audit be on these legal thefts or will they be also on going long on the numbers, which means cheating the Indians?

Mr. ADAMS. Senator, I would like to point out that I support Mr. Pettingill's comments here and I'll give you a specific example. One of the companies we audited last year operates a gas plant and under regulations they are entitled to two-thirds of the value of the product for manufacturing allowances. Now, for nine straight years they had claimed manufacturing allowance of 48 percent. You don't have to be too intelligent to figure out that conditions did not remain static in that plant for nine years. After reviewing one year's operating cost, we reduced the manufacturing allowance from 48 percent to 16 percent.

In talking to other audit groups, that is a fairly standard experience, that once you take a hard look at these numbers, they have a tendency to disappear. In addition to that 66⅔ percent allowance, if a company comes back in and requests additional allowances, it's given to them. But experience doesn't point out that they need the additional allowance. Experience doesn't point out that they need the 66⅔ percent.

Senator DECONCINI. And much of that is uncovered by the independent——

Mr. ADAMS. By audit, and audit only.

Senator DECONCINI. Your auditing?

Mr. ADAMS. That's correct, Sir.

Senator DECONCINI. And Mr. Pettingill, when you say legal theft, what you mean is stealing that has been approved, is that what you mean?

Mr. PETTINGILL. Yes, sir.

Senator DECONCINI. Such as exorbitant allowances that you can't justify?

Mr. PETTINGILL. Correct.

Senator DECONCINI. Thank you, gentlemen. We appreciate your testimony very much.

Senator DECONCINI. Our next panel of witnesses will be Mr. Burton Hutchinson, Chairman of the Arapaho Tribe; Mr. Richard Ortiz, Director of Tax Commission, Wind River Tribes; and Kevin Gover, Attorney for the Wind River Tribes.

Gentlemen, would you please come forward and be sworn.

[Witnesses sworn.]

Mr. BRANDOLINO.

STATEMENT OF RICHARD ORTIZ, DIRECTOR, TAX COMMISSION, WIND RIVER TRIBES, ACCOMPANIED BY KEVIN GOVER, ATTORNEY, WIND RIVER TRIBES

Mr. BRANDOLINO. Thank you all for coming today. Mr. Ortiz, could you just briefly describe your title and how long you've been with the tribes?

Mr. ORTIZ. My name is Richard L. Ortiz, I'm the Director of the Wind River Tax Commission for the Shoshone and Arapaho Tribes on Wind River Reservation in Wyoming. I've been with the Tax Commission for 17 months.

Mr. BRANDOLINO. Could you describe the natural resources that are located on the Wind River Reservation?

Mr. ORTIZ. As most tribes, we have timber, we have coal, we have oil and gas. Oil and gas is the only resource being produced at this time on Wind River.

Mr. BRANDOLINO. And how many leases are currently in effect?

Mr. ORTIZ. We have 105 leases.

Mr. BRANDOLINO. And how much in royalties did the tribe receive in 1988?

Mr. ORTIZ. Approximately $7.5 million.

Mr. BRANDOLINO. Could you describe the efforts of the tribe in monitoring its royalties?

Mr. ORTIZ. The Joint Business Council of the Shoshone and Arapaho Tribes in 1986 implemented the Wind River Tax Commission.

They have invested approximately $1.5 million into the infrastructure of the Tax Commission. The regulations of the Tax Commission require that the oil companies provide directly to the tribes the source documents utilized by MMS.

Mr. BRANDOLINO. So you have in place a system, the Northern Utes and the Southern Utes have in place, where you receive documents pursuant to your severance tax information directly from the companies and you compare this information with information received by the Minerals Management Service?

Mr. ORTIZ. That is correct.

Mr. BRANDOLINO. Without the tribal severance tax, would the tribe have been able to receive these documents directly from the company?

Mr. ORTIZ. No.

Mr. BRANDOLINO. Why would it be a problem if the tribes had to rely exclusively on information provided from the Federal Government?

Mr. ORTIZ. The reports that we receive from Minerals Management Service are cumbersome, confusing, there is no explanation for some entries that are backed out of the system, we have no explanation of those types of things. In fact, Minerals Management Service, up until March of 1988, did not know the Lease Universe on Wind River.

Mr. BRANDOLINO. Why do you think this? Why do you have reason to believe that they didn't know the Lease Universe?

Mr. ORTIZ. Two individuals from Minerals Management Service out of the Lakewood, Colorado office contacted me and came up to my office and requested to download the tribes rev-check system and at that time they had 30 percent of the total leases.

Mr. BRANDOLINO. They had 30 percent of the total leases accounted for?

Mr. ORTIZ. Yes.

Mr. BRANDOLINO. What is the tribes rev-check system? Could you explain that a little?

Mr. ORTIZ. The rev-check system implemented by the tribes is a system developed by the international accounting firm of Ernst & Whinney out of Houston, Texas. It is unique to Wind River in that it analyses both severance tax payments to the tribes and royalty payments to the tribes.

Mr. BRANDOLINO. With this system have you been able to identify underpayments of royalties?

Mr. ORTIZ. Yes, we have.

Mr. BRANDOLINO. Could you, as the other tribes have today, tell us what you think are the most common sources of underpayments?

Mr. ORTIZ. Basically, for gas, it's major portion analysis. For oil, we've had problems with the highest posted price. In fact, for the year 1986, we've just completed the severance tax audit and in conjunction with that severance tax audit, we have identified $300,000 in underpayment of royalties to the tribes.

Mr. BRANDOLINO. In situations where the tribe has uncovered underpayments, has the tribe made any efforts to demand payment from companies?

Mr. ORTIZ. No.

Mr. BRANDOLINO. Why?

Mr. ORTIZ. We do not have the authority to do so.

Mr. BRANDOLINO. Does the tribe have an agreement, either a joint audit agreement or a 202 agreement, with Minerals Management Service?

Mr. ORTIZ. We have applied for section 202 funding under the 1982 act. Three weeks ago we were notified by MMS we were rejected.

Mr. BRANDOLINO. Why were you rejected?

Mr. ORTIZ. Their explanation to us was that my staff, who are tribal members of the Shoshone and Arapaho Tribe, their education was not adequate. In addition to that, we didn't identify the leases that we would like to audit.

Mr. BRANDOLINO. Despite this rejection, will you continue to monitor through this rev-check system your royalty payments that you receive?

Mr. ORTIZ. Yes; the one problem that we do have with that is that MMS has instructed us not to communicate with them. Any communication that we have or would desire to have with them should be directed through the Bureau of Indian Affairs.

Mr. BRANDOLINO. When did they inform you of this?

Mr. ORTIZ. Last year.

Mr. BRANDOLINO. Do you have any concerns, as the other tribes have mentioned today, regarding the Minerals Management Service recent unilateral change in audit strategy?

Mr. ORTIZ. Yes; we do. As you're aware, and as we're extremely aware, during the years of 1981–1983, oil and gas prices were extremely high relative to prices today. We have identified approximately $7.5 million in that time period of underpayments in royalties. We feel that if MMS closes out this period without our at least reviewing the audits for those leases, that revenue will be lost to the tribes forever, the door will be shut.

Mr. BRANDOLINO. How have you identified $7 million in underpayments?

Mr. ORTIZ. We have completed the audits for the severance tax payments for the years 1979 through 1985. In conjunction with those audits, we have the ability and the capability to monitor and audit the royalty payments and, as such, we have determined that there is approximately $7.5 million in underpayments of royalties just for those three years.

Mr. BRANDOLINO. Due mainly to improper evaluation?

Mr. ORTIZ. To major portion analysis and also, as the other two tribes this morning stated, we feel that there are extreme allowances taken, especially by one company that has a gas plant on the reservation. Up until this year they were taking the maximum deduction, 66⅔ percent. They've since adjusted that to 19 percent.

Mr. BRANDOLINO. Have they adjusted that as a result of pressure by the tribe?

Mr. ORTIZ. Yes, by our severance tax.

Mr. BRANDOLINO. The other tribes also provided some comments on the Supreme Court's *Cotton Petroleum* decision, which allows multiple taxation on reservations. How will this effect the Wind River Tribes?

Mr. ORTIZ. We feel that it will hinder future exploration and production. We also feel that the smaller oil companies will move off the reservation. Our tax rate on Wind River is 27 percent, that's double the amount on the rest of the State.

Mr. BRANDOLINO. Is that just severance tax?

Mr. ORTIZ. The State imposes a severance tax, an ad valorem tax, and a conservation tax. The tribes impose a severance tax.

Mr. BRANDOLINO. And that all totals to 27 percent.

Mr. ORTIZ. That's correct.

Mr. BRANDOLINO. Can you break that down?

Mr. ORTIZ. The tribes impose currently a 13½ percent tax on oil and gas produced on the reservation. We only collect 4 percent. We issue a credit for 9½ percent in order to avoid litigation with the State and the county and to avoid the problems of the oil companies paying under protest, which would severely hinder the school districts. There are six school districts right now and the county's budget——

Senator DECONCINI. Excuse me, that means you in essence credit them back, you give that back to them?

Mr. ORTIZ. Well, we have not collected it, we keep track of it.

Senator DECONCINI. You just don't collect it.

Mr. ORTIZ. If it is paid to the State, we give them a credit, I'm sorry.

Senator DECONCINI. The 13 percent that you receive, 9 of that you don't actually collect, is that right?

Mr. ORTIZ. That is correct.

Senator DECONCINI. Is part of that so that you are competitive with the producers that are not on reservation lands?

Mr. ORTIZ. Yes.

Senator DECONCINI. Because obviously they don't pay 27 percent, right?

Mr. ORTIZ. Yes.

Senator DECONCINI. Thank you.

Mr. BRANDOLINO. One last point on this matter before we move to Mr. Gover, who is the resident expert on this subject.

You had mentioned that small companies have intimated to you that they may not be able to do business on the reservation because of this multiple taxation, is that true?

Mr. ORTIZ. Yes; that's true. Two companies have informed me that should the credit be removed both the State and the tribes start collecting the 13½ percent that each imposes, they would be forced to move off the reservation. Those two companies produce approximately 50 percent of the natural gas produced on Wind River and approximately 20 percent of the total production of oil and gas on Wind River.

Mr. BRANDOLINO. Mr. Gover, you are an attorney with the Tribes and also an attorney with the law firm of Gover, Stetson, Williams, & West, is that correct?

Mr. GOVER. Yes.

Let me clarify the record. We represent the Wind River Tax Commission and the Shoshone Tribe of the Wind River Reservation.

Mr. BRANDOLINO. And your firm also represents several other tribes, is that correct?

Mr. GOVER. That's correct.

Mr. BRANDOLINO. Ms. Susan Williams is another partner of your firm and was previously chairman of the Tax Commission for the Navajo Tribe, is that correct?

Mr. GOVER. That's correct.

Mr. BRANDOLINO. I understand that your views that you are presenting today are also the professional views of Ms. Williams?

Mr. GOVER. Yes; Susan and I co-wrote the testimony.

Mr. BRANDOLINO. I thank you for submitting that testimony.

We've asked you to evaluate *Cotton Petroleum* v. *New Mexico.* Could you just state briefly as to what the Supreme Court stated in that decision?

Mr. GOVER. There were basically two holdings of the Court in *Cotton Petroleum.* The first was that State taxation of mineral production on reservations by non-Indian lessees acting under the 1938 Indian Mineral Leasing Act is not preempted. The second issue was whether the commerce clause of the Constitution erects any barrier to State taxation of mineral production on Indian lands when the tribe also is taxing that production. And, again, the Court found that State taxation was not prohibited by the commerce clause.

Mr. BRANDOLINO. There was a previous Supreme Court decision, *Montana* v. *Blackfeet,* is that correct?

Mr. GOVER. That's correct.

Mr. BRANDOLINO. And that decision held that States may not tax Indian royalties directly, is that correct?

Mr. GOVER. Correct.

Mr. BRANDOLINO. Did *Cotton* actually reverse that decision or did it address it in any way?

Mr. GOVER. It did address it. They did not reverse it, they distinguished the situation saying that State taxation of the activities of non-Indian lessees under the 1938 Act is distinguishable from State taxation of royalty payments made under the 1938 act.

Mr. BRANDOLINO. The decision in *Cotton* again held that States are free to tax companies on Indian reservations.

Mr. GOVER. That's correct.

Mr. BRANDOLINO. I'd like your comments first. Do you believe that the decision was incorrect as a matter of law?

Mr. BALLEN. Mr. Gover, before you get to that, let me just ask you some things so we'll all understand what we're talking about. This decision primarily rested on statutory interpretation, is that correct?

Mr. GOVER. That's correct.

Mr. BALLEN. So this is something within the power of Congress. Indeed, both the dissenting and majority opinions of the Supreme Court asked the Congress for guidance because they were working on a blank slate in trying to interpret these statutes.

Mr. GOVER. I would consider that a kind characterization of what the Court did. But very clearly it's within the power of Congress to amend the 1938 act or to address the problem of dual taxation.

Mr. BALLEN. And that's why you're here today, in effect, is to ask this committee to look into any possible legislative remedies to the problem?

Mr. GOVER. Yes.

Mr. BALLEN. Thank you, sir.

Mr. BRANDOLINO. As a matter of law, do you think that the *Cotton* decision was wrongly decided?

Mr. GOVER. I did think it was incorrect for two reasons primarily.

First, it was inconsistent with the prior development of the case law under the 1938 act, *Montana* v. *Blackfeet Tribe* being the first example where the Court relied quite heavily on the fact that the purpose of the 1938 act was to maximize Indian income from oil and gas resources on the reservation. The Court rather cavalierly swept aside the proposition that if the States add a tax burden above and beyond what is imposed by the tribes in the form of both taxes and royalties, that that will have a negative effect on Indian income from tribal oil and gas resources.

Second, it was inconsistent with the *Crow* case which was affirmed only last year. Admittedly, the case was affirmed summarily and there was no opinion issued by the Supreme Court in the case. Nevertheless, we had reason to believe that the Court agreed with the Ninth Circuit's interpretation of the 1938 act as preempting State taxation of mineral production on the reservations.

Mr. BRANDOLINO. How about as a matter of public policy? Do you think the decision is wrongly decided?

Mr. GOVER. I do. It's interesting because the Supreme Court in essence has made public policy. Given the decision in *Blackfeet,* given the decision in the *Crow* case, it would have been quite an easy thing for the Court to find preemption in this case. Instead, I think if you read the opinion carefully, the Court was making policy and its determination of proper policy was to allow States to tax this production. I think that's incorrect because I think it will inhibit production on the reservations and it goes to the very heart of the trust responsibility in the sense that these resources are part of the corpus of the trust. For the United States to allow the States to take a cut off the top of the value of the resource is clearly contrary to the trust responsibility.

Mr. BRANDOLINO. The first point that you mentioned, that the decision may inhibit production and development, let's elaborate on that. Do you believe that the companies will abandon wells because of this decision?

Mr. GOVER. I believe that the producing life of marginal wells on the reservations clearly will be shortened by the fact that they now have to pay State taxes above and beyond the tribal taxes and tribal royalties. That seems obvious.

Mr. BRANDOLINO. How about production? Do you think future production will be halted in some way?

Mr. GOVER. Yes; they will have to shut down those wells earlier than they would have otherwise.

Mr. BRANDOLINO. Future development also?

Mr. GOVER. I think future development is the area that will really be impacted. If a company has two prospects and has to choose one of them for exploration and development, and one is on an Indian reservation and one is not, there is by definition a higher tax burden on the reservations unless the tribe chooses not to tax, which is not an option, frankly.

Given that, the on-reservation prospect has to be demonstrably superior to the off-reservation prospect for it to be the one selected for development. Given that these decisions are made in the margins and the oil business is a tough business, it is clear to me that Indian lands fall to the bottom of the list when the companies begin developing new prospects.

Mr. BRANDOLINO. In fact, we have testimony from tribes today that have said that companies have actually mentioned to them that this decision may hinder their production and may hinder their development.

Mr. GOVER. I just see that there will be no question about that.

Mr. BRANDOLINO. The second point you made was that the decision somehow infringes on tribal sovereignty. In what way?

Mr. GOVER. Well, in two respects. When you look at oil and gas, or any kind of a royalty producing situation, a company comes in, it has its production costs, it also needs to make a certain amount of money, and the rest is what's left for the owner, the tribes. The tribes have two forms of income from the production; one is taxes and one is royalties. Given that you add this State tax burden to the total cost of production, that limits the amount by which the tribes can either negotiate for higher royalties or can increase their tax revenues.

Second, it inhibits our tax policy because we are unable to provide incentives for companies to come onto the reservation in the form of lower taxes. For example, if a tribe had a tax equivalent to the State tax, in order to encourage production and exploration, they could lower their tax; but that's an ineffective strategy now that the State tax is going to be tacked on on top of tribal tax and tribal royalty payments.

Mr. BRANDOLINO. Do you have any ideas on how this multiple taxation can be alleviated?

Mr. GOVER. There are several ways to approach it. I think first of all we start with the proposition that the tribal taxes have to be in place. These are the poorest people in the country, these are the poorest governments in the country. They have huge responsibilities and responsibilities that are increasing as the Federal budget on Indian reservations diminishes. They've got to generate this revenue. So we leave the tribal taxes in place. From there the question is, do you cut the State tax burden or do you cut the Federal tax burden? If you look at cutting the State tax burden, there are a number of difficulties that you're going to run into, not the least of which are political difficulties. The States feel that they have a legitimate interest in taxing non-Indians on the reservation. I believe that they do to the extent that some of that money is returned to the reservation.

In the case of Wind River, what we found over about an 8-year period beginning in 1977 was that the State of Wyoming took $77 million more in tax revenues than it returned to the reservation in the form of services. Nevertheless, States do provide certain services on the reservations that have to be accounted for, not the least of which are the six school districts at Wind River. So we have to be sensitive more to the local and county governments' interest and the services they provide than we do the States because the fact is the States are not dependent on tax revenues from Indian

reservations. They have a much, much larger tax base than we do, they have other alternatives for raising revenue. Local governments don't.

Another option that is available is to provide Federal tax relief, and that can be provided in the form of credits for State taxes paid on reservation production, which is preferable because that provides more of a dollar-for-dollar return and levels out the playing field so that the tax burden on reservations is no higher than it is off.

The third alternative might be to provide some sort of Federal deductions. But the deductions aren't as attractive because the return on a deduction, the actual tax break that's given, is dependent on many other factors outside of the on-reservation production.

That's really the range of alternatives that we've come up with so far. Of the three, the one I think the tribes would prefer would be to put a limit on State taxation on the reservation and require the States, if they're going to tax on the reservations, to provide services in an amount equivalent to the tax revenues they're taking.

Mr. BRANDOLINO. And whatever the alternative, this is clearly an issue for Congress to consider.

Mr. GOVER. Congress clearly has the authority under both the plenary power doctrine and the commerce clause to legislate on the issue.

Mr. BRANDOLINO. I'd like to close up with Mr. Ortiz, and then ask you where you see the Wind River Tribes going in their efforts to monitor royalties with its severance tax?

Mr. ORTIZ. First, we would like assistance from the committee in helping us obtain 202 funding or somehow clarifying the issue and the ambiguities by MMS on the abilities of tribes to 638 contract the royalty-auditing function.

The tribes on Wind River have implemented the necessary infrastructure at this time to audit and monitor royalty payments. Through our severance taxes we have collected approximately $2 million in back taxes, penalty, and interest. We expect to collect another $2.5 million within the next 90 days. We have also identified in conjunction with those severance tax audits approximately $10 million in underpayments for the period of 1979 through 1986.

We have implemented a Minerals Department out of our severance tax payments which physically monitors on-site the leases, which has reduced theft and underreporting.

The Wind River Tax Commission, of which I am the Director, does the financial monitoring of those payments, severance tax and royalties. With adequate funding we can monitor and audit royalty payments because we understand the oil and gas situation on Wind River better than anyone else in this country, and that includes MMS.

The last thing I would like to say is that in my opinion the Shoshone and Arapaho Tribes do not need MMS. We can do the job better than they can.

Mr. BRANDOLINO. Thank you. Counsel Klingenstein has a few questions for Mr. Gover.

Mr. KLINGENSTEIN. Mr. Gover, in order to correct the *Cotton Petroleum* decision, what legislative acts would have to be amended by Congress?

Mr. GOVER. Well, you have a couple of alternatives. One is to amend the 1938 Indian Mineral Leasing Act and the 1982 Indian Mineral Development Act, which are the two statutes under which virtually all new leases are made at this point. And just make it extremely clear that State taxation is prohibited on production arising pursuant to agreements made under those acts.

Mr. KLINGENSTEIN. Prior to the handing down of the decision, do you know whether States and tribes had gotten together to try to work out a settlement of this issue?

Mr. GOVER. As a matter of fact, the Wind River Tribes have a standing agreement with the State of Wyoming concerning production that was based in large part on our analysis and the State's analysis of the prospects for the decision in *Cotton.*

Mr. KLINGENSTEIN. And has this decision then frustrated some of those negotiations?

Mr. GOVER. It cuts our legs right out from under us. We don't have much to negotiate with on taxes right now.

Mr. KLINGENSTEIN. Let me ask you whether you recommend that Congress retroactively change the law?

Mr. GOVER. Retroactivity is difficult to understand. Some of the cases, like the *Crow* case right now, the tribe is making a claim for taxes Montana allegedly unlawfully collected over 10 years ago. If we ask Congress to say that retroactively the 1938 act preempts State taxation, that opens the door for a very large raid on several State treasuries throughout the United States. I think probably that there will not be support for that in Congress.

Mr. KLINGENSTEIN. Is it correct that some of these State taxes over the last several years have been paid in escrow waiting for this decision?

Mr. GOVER. They are. All over the United States where companies were challenging the State's right to tax, including Wyoming, and under State law those payments have to be held in escrow.

Another source of possible revenue, though, for making up for the taxes the States have been collecting over the years is a good deal of that money goes into State permanent funds and the tribes never see that money. That money is very rarely expended for on-reservation purposes, yet a great amount of it comes from the reservation.

Mr. KLINGENSTEIN. Is there any argument that could be made that, in fact, it is the tribes who are due the back taxes that were paid into escrow?

Mr. GOVER. Yes; particularly in the circumstances where a tribe also was taxing at that time. The tribes can make the claim that in essence the State was unlawfully collecting money that was properly payable to the tribes and where that money can be identified and is in a discrete fund within the State, like the permanent minerals funds, the tribe can make the claim that the State in essence is holding that in constructive trust for the benefit of the tribes.

Mr. KLINGENSTEIN. The argument being that the tribe's tax was artificially lower because of the State's tax?

Mr. GOVER. That's correct.

Mr. KLINGENSTEIN. Thank you.

[Prepared statement of Mr. Gover appears in appendix.]

Senator DECONCINI. Gentlemen, thank you. That was very helpful testimony, Mr. Gover, regarding the Supreme Court case and how it should be addressed. Your testimony is going to be very helpful to this committee in its final recommendations.

Thank you, gentlemen, very much for appearing today. We appreciate your being here.

This committee will stand in recess until 2:00 p.m. this afternoon.

[Whereupon, at 11:57 a.m., the committee recessed, to reconvene at 2 p.m., this same day.]

AFTERNOON SESSION—2:15 P.M.

Senator DECONCINI. The Special Committee on Investigations will come to order.

Senator McCain will be here shortly. He is at the Armed Services Committee and approves that we proceed here.

The next panel the committee will hear from is Chuck Norman, the accountant of the Special Committee on Investigations. He testified before us before. And we will also hear from Randy Fetterolf, oil and gas expert, consultant to the Special Committee on Investigations. Will you two gentlemen come forward, please?

[Witness sworn.]

STATEMENT OF RANDY FETTEROLF, OIL AND GAS EXPERT, CONSULTANT, SPECIAL COMMITTEE ON INVESTIGATIONS

Senator DECONCINI. Mr. Ballen will conduct the questioning.

Mr. BALLEN. Thank you very much, Mr. Chairman.

Mr. Fetterolf, good afternoon. Can you provide for the committee a brief summary of your background and qualifications for the record? I think that would be in order.

Mr. FETTEROLF. Yes, sir. My name is Randy Fetterolf. I graduated from the University of Colorado in 1978 with a degree in accounting.

I was employed by Mobil Oil Corporation for three and a half years as an operations auditor, auditing Mobil's field operations and internal accounting procedures.

From there I became the supervisor of royalty auditing for the State of Wyoming in the State Auditor's office. There, I was responsible for the supervision of 15 staff auditors. Our primary mission was to audit and recover federal mineral royalties shared by the State of Wyoming.

In the five years I was fortunate enough to work for the State Auditor, Mr. Jim Griffith, we managed to identify and collect over $80 million in federal and state oil and gas royalties.

Since 1986, February, I have been a consultant with my own firm. We perform audits for ranchers, fee owners, Indian tribes, oil and gas companies, and have recovered many millions of dollars for those folks, as well, since that time.

Mr. BALLEN. Let me ask you this question: what is the name of your company now?

Mr. FETTEROLF. My firm is known as Wyoming Royalties, Incorporated.

Mr. BALLEN. Where is it located?

Mr. FETTEROLF. Cheyenne and Casper, Wyoming.

Mr. BALLEN. Now, if I understand your experience correctly, you were an auditor for a major oil company, Mobil. Subsequent to that you worked for the State of Wyoming and participated in a program that successfully recovered $80 million in royalties. Those were royalties the Federal Government missed?

Mr. FETTEROLF. That's correct.

Mr. BALLEN. And you and the people you worked with were successful in recovering those royalties?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. Sir, is it your business now in Wyoming Royalties, Inc., to recover for private fee holders—Indian tribes, county units of government, etc.—money in royalties from oil and gas that the Federal Government misses?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. So this is your area of expertise, and, indeed, it is your business?

Mr. FETTEROLF. That's correct.

Mr. BALLEN. And how much did you say you have been successful in the last several years in recovering?

Mr. FETTEROLF. In the last three years—again, some of our clients include county governments that have ad valorem taxes on minerals, large ranchers—we have managed to identify and collect over $6 million for those clients.

Mr. BALLEN. So you have a fairly impressive record, both with the State of Wyoming and in your own business, in collecting royalties that the Federal Government has missed?

Mr. FETTEROLF. I'd like to think so.

Mr. BALLEN. Would that be a fair statement?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. Thank you, sir.

Now, as a result of your expertise, sir, did the Special Committee retain you to help it conduct an analysis of companies doing business on Indian lands?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. And in the course of that employment, sir, have you examined records from numerous companies?

Mr. FETTEROLF. Yes. The committee subpoenaed documents from 30 mineral companies that represented over 80 percent of all Indian minerals being reported and paid to the Federal Government.

Mr. BALLEN. And were these companies also placed under oath?

Mr. FETTEROLF. Yes, they were.

Mr. BALLEN. And what kind of records were subpoenaed from the companies?

Mr. FETTEROLF. We asked for virtually any record associated with a group of selected Tribal and allotted leases. We asked for internal documents concerning the accounting and reporting and payment, and also the computation of Indian mineral royalties.

We also asked from these companies their internal policies, philosophies, evidence, and documents concerning ongoing litigations that they had in progress.

We asked them for things that came off their actual accounting systems, including computer data.

Mr. BALLEN. Now, was the committee able to obtain from companies documents never before turned over to any government agency?

Mr. FETTEROLF. Yes, sir. Because of my knowledge and experience with the mineral industry, I had some idea of the kinds of records that may have never been asked for before, and we included those in our subpoenas and interrogatory questions.

Mr. BALLEN. Now, sir, how many documents were—and did the committee collect sensitive proprietary information from companies?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. And how many documents were actually subpoenaed—approximation in pages entered into the filing and computer systems of the Special Committee?

Mr. FETTEROLF. We ended up obtaining and reviewing over 700,000 documents.

Mr. BALLEN. Would that be pages involved, or actual documents?

Mr. FETTEROLF. It would be a combination of both, really. Some of those documents had a lot of pages. I think there may have been upwards of one million documents before we got done.

Mr. BALLEN. Thank you, sir.

In seeking those documents, did we attempt also not only to represent 80 percent of the universe, but to get a geographical dispersion of the various interests held?

Mr. FETTEROLF. Yes, sir. With the information provided from the MMS on producing Indian leases, we went in and selected leases to assure that we were covering—especially geographically—we ended up covering royalties for 24 Tribes in 11 states.

Mr. BALLEN. Now, the committee developed questions from all these documents submitted and placed a number of the companies under oath to attempt to obtain answers to the questions?

Mr. FETTEROLF. Yes, sir. We placed 19 oil and gas companies under oath in that manner.

Mr. BALLEN. Now, what was the nature, sir, of the questions put to the companies under oath?

Mr. FETTEROLF. From our review of the subpoenaed documents and records we identified areas in which we thought there might be a potential for underpayment of royalties. We also identified some traits and common themes in those companies' philosophies, if you will, on their treatment of Indian lands and Indian minerals.

We tried to direct our questions to those major issues that had been identified, looking both at the subpoenaed documents and what we had learned from MMS and the Tribes and allottees you have heard from today.

Mr. BALLEN. Sir, what were your major findings?

Mr. FETTEROLF. Primarily we found—and this is very important—that the companies, themselves, in their internal accounting systems, do not give any special consideration or treatment of Indian lands as a type of lease or type of production. In other

words, there is no unique treatment by the companies, generally, in their systems to account for royalties.

As you heard this morning, some of the special considerations involved when you go to value, compute, and pay Indian royalties, are much different than public lands, and also a typical fee owner or private land owner.

We did find, again, that those companies have generally made no special provisions within their accounting systems to assure that when an Indian lease is at stake, something telling those accountants, "This is a special lease. This lease is different."

We also found things that would confirm much of what you heard this morning from the tribes that came and spoke.

Overall, we found that the companies generally are not performing some of the analysis, some of the things that are required by the Indian lease, particularly in the area of valuation.

We found that companies have taken positions on items or issues that are interpretive in nature, and, true to form, those companies have taken positions that are to their benefit in those areas.

Finally, we also found that there have been deductions taken from royalties with or without approval of Interior or Minerals Management Service, and that those deductions have resulted in underpayments of Indian royalty.

Senator DECONCINI. Excuse me, Mr. Ballen.

Deductions and allowances? Is that one and the same thing to the term that was referenced this morning?

Mr. FETTEROLF. Yes, Senator.

Senator DECONCINI. Thank you.

Mr. BALLEN. Mr. Fetterolf, so the record is clear, what kind of issues are these that you have found that the companies were involved with? Maybe my question is not clear.

You testified that the companies took interpretive issues in their favor. Is that a criminal action?

Mr. FETTEROLF. Unlike the crude oil theft being taken from crude oil tanks we heard about earlier in the week, or from mismeasurement, what we found were more like things that, when given an opportunity to interpret a given rule or a regulation or concept within the lease terms, given that opportunity, the companies tended to interpret things their way. That is, that would result in their idea of the proper valuation for royalty, and, commensurately, their idea of what they owed.

Mr. BALLEN. We live in a free market economy. Is that what we would expect? What is the problem with the companies doing that, sir?

Mr. FETTEROLF. Not necessarily a problem. As you pointed out, in a free market economy with a competitive industry like this, this is what you'll find, in fact. However, when it comes to Indian lands, and when it comes to the Indian lease and the requirements thereof, again I think it is fairly obvious that the valuation of those royalties is somewhat different and somewhat unique.

Mr. BALLEN. Let me ask you this question: isn't the government supposed to be protecting the interest of the Indians in this regard? That is why the MMS is there. That is why the regulatory agencies are in effect, is it not?

Mr. FETTEROLF. Yes, sir. And it is my understanding that the Secretary of Interior has a trust relationship and a trust responsibility to assure just that.

Mr. BALLEN. So the problems, in other words, in this area are related more to the government's failure than any intentional effort on the part of companies to cheat or steal or what have you?

Mr. FETTEROLF. I would have to say so. Yes.

Mr. BALLEN. Because naturally they are going to do what is in their interest to do economically?

Mr. FETTEROLF. That's correct.

Mr. BALLEN. Sir, what is the major cause of underpayment that you found?

Mr. FETTEROLF. Mr. Ballen, that is an issue that we heard much about this morning, and the vernacular for it is "the majority price analysis."

Mr. BALLEN. I'm going to ask you to give an explanation of what is meant by major portion analysis, majority pricing analysis, major field—I have heard a number of terms used. Give us your best description of what this is.

Mr. FETTEROLF. I'll try to put this in English. The lease, itself, for the Indians say that the Secretary of Interior, when considering the value for Indian lands, and when the lessee is going about computing and paying those royalties and considering the valuation, he must look to other transactions in the area or field in which that lease is located—and preferably at arm's length, preferably the transactions between competitive buyers and sellers. He must look to those other sales in the area and assure that the value he uses for royalty approximates or is very much like that fair market value for the whole area.

The majority aspect, Mr. Ballen, is the catch for assuring that unrealistic values are not assigned to Indian lands and Indian royalties. It must be a majority of those prices occurring in the area.

Mr. BALLEN. So the major cause of underpayment that you found from the companies was the failure to perform major portion analysis?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. Now, did you find that a significant number of sales of oil and gas produced on Indian leases are inter-company sales or sales that are made between one company and its affiliates?

Mr. FETTEROLF. Yes, sir, we did. The respondents to our interrogatories—which again I'll remind you represent approximately 80 percent of all Indian oil and gas royalties that are paid, we were told by the companies, themselves, that for oil, approximately 50 percent of the oil they produce and sell they bought themselves. For gas it was less so, approximating 25 percent, again based on the respondents' own answers and sworn testimony. About 25 percent of the gas that they were producing on Indian lands they were also buying through an affiliate company.

Mr. BALLEN. Why is this non-arm's length transaction important in the major portion analysis or the failure to perform such?

Mr. FETTEROLF. Normally, when you have a willing seller and a willing buyer that have no connection to each other, you can be fairly well assured that each is going to try to maximize his position in the transaction. Because they have no relationship, you can

be fairly assured that that sale will represent the best deal either one could make.

When a company is actually selling its production to itself, the incentive is not there. You lose the objective nature of that transaction, and the values that are used can often be the company's own idea of what those products are worth.

To extend that, when I worked for Mobil Oil Corporation, every year it became a question as to whether Mobil's marketing entity downstream of the well, or Mobil's producing entity was going to have the best looking P&L. By simple—if the producing company got a good deal from its own marketing company, then that year the producing entity would have a much better-looking set of books or profit.

Because of all these things, it is really kind of like the fox in the hen house, because the companies are supposed to be making some sort of attempt to assure that their prices are representative of a free and open market. When they're buying their own products, that becomes very difficult.

Mr. BALLEN. And this becomes a particular problem in the major portion analysis area.

How many companies, according to our work in subpoenaing and putting these companies under oath, have failed to conduct major portion analysis?

Mr. FETTEROLF. Virtually all of them, Mr. Ballen. I'd like to speak to that.

We asked the question, "When you are selling at non-arm's length, or to yourself, how do you go about assuring the proper valuation for the Indian lease terms?" Without exception, each company responded, "We have always and continue to pay Indian royalty on the basis of our gross proceeds from the sale or our amounts realized from the sale."

By saying that, by suggesting that the amounts realized has always been their basis, they told us that they are not doing majority price analysis, that they have—and especially in the case of non-arm's length sales. When they say the gross proceeds, what does that really mean if, in fact, their marketing company is buying that, as I just described. If it is a year in which the marketing company is to look good and have a good P&L, then the price is going to be higher.

Mr. BALLEN. Good profit and loss?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. Now, is this more a problem in the area of oil where there are posted prices in the field, or is it largely a problem in the area of natural gas pricing?

Mr. FETTEROLF. Primarily in the area of natural gas—especially of late, when the prices for oil have been relatively flat. And also, the accounting involved in gas is much more complicated than in oil.

The companies, themselves, have suggested to us, to MMS, and to the lessors, that they are unable and unwilling to do this kind of analysis.

Mr. BALLEN. Why is that?

Mr. FETTEROLF. They have suggested everything from anti-trust violations—that is, if they were to go and seek out and learn the

prices of their competitors, they may be involved in an anti-trust scenario in doing so. They claim they do not know the prices of their competitors and are not supposed to know them.

When it comes to oil, most, if not all, purchasers of crude oil will post a price that they are willing to pay for that oil for a given period—day, week, or month. That posting is their telling everyone out there who may want to sell them oil, "We will purchase oil for this period at this price." Those are public information—easily available.

If a company wanted to make sure that their oil royalty payments to Indians were properly valued, they could relatively easily check the other major buyers and sellers of oil in the area through those postings and make that determination.

Mr. BALLEN. So the net result of the major portion analysis not being performed is a loss of royalties to the Indians who are entitled to them; is that correct?

Mr. FETTEROLF. Yes, sir. And it is easily the largest area of loss.

Mr. BALLEN. What would be the next greatest failure that the committee uncovered from the company responses to subpoena and being placed under oath?

Mr. FETTEROLF. The next greatest failure we found is a beast known as the NTL–5.

Mr. BALLEN. What is the NTL–5? And we all realize this is a rather technical area, but it is significant to the Indian lease-holders involved. What is NTL–5?

Mr. FETTEROLF. I'll do my best. In 1977, the then USGS—the predecessor to MMS—put out a notice to lessee.

Mr. BALLEN. An NTL?

Mr. FETTEROLF. NTL. Right. And the notice to all lessees in essence said that for gas——

Mr. BALLEN. This was number five, I presume?

Mr. FETTEROLF. It was also number five, that's correct. I've never seen one through four, but this was number five.

In any event, the essence of it was that it was commensurate with the Natural Gas Policy Act of 1978, which established ceiling prices that could be obtained for gas sales based on several conditions of the given well: when it was drilled, how old it was, how deep it was, how costly it was to get that gas. The ceilings were established under the NGPA.

In putting out the notice to lessees—particularly for Indian lands in which you must achieve a fair market value— the lessees were instructed to value their gas at the NGPA ceilings, whether they could get those prices or not.

That notice to lessee remained in effect until 1987.

Mr. BALLEN. What happened in 1987? Did Congress intervene at that point in time?

Mr. FETTEROLF. In 1987, Congress did intervene. What had happened: in 1983 and 1984 the gas market went very flat and just went belly up, and nobody was getting the kinds of prices that the NGPA ceilings entailed.

For example, when NGPA was in effect and when the NTL was in effect, you could have two wells right next to each other and, because of the conditions of those wells, or the criteria for the NGPA ceiling, you could be selling some stream of gas from one

well and be getting 20 or 30 cents per MCF—thousand cubic feet. The next well right nearby could be selling for $8 or $9 per MCF—basically the same gas.

What happened is that the purchasers—there became a gas glut, a bubble. The purchasers of gas refused to honor the contract provisions that called for their paying these ceiling prices—these high prices.

The essence of that was that the sellers of gas were no longer able to obtain these higher prices.

The term is "market out." The sellers were subjected to the buyers' marketing out their contract; in other words, saying, "We can no longer pay you $8 for this gas. To us it is no longer worth that. Now it is only worth $2 to $3." And that has been the price of gas.

Mr. BALLEN. So there was an equity interest involved in Congress intervening in this situation. What was the result of Congress' intervention? Was a law passed? The NTL-5 Act?

Mr. FETTEROLF. Yes, sir. The NTL-5 Act of 1987 was passed. And, in effect, it recognized first that the buyers and sellers of gas—particularly the sellers—were being forced to pay Indian and federal royalties on gas prices that were unobtainable and artificial because the market had gone to heck.

The Congress recognized that this was placing a burden on the federal lessees. So they said, "We're going to remand this NTL. We're going to undo it. We're going to allow you to pay on your proceeds within other tolerances we have discussed. But we will allow you to pay on the marketed out price from your buyer back to 1983." They did not go back any further than that.

Senator DECONCINI. What is the marketing out price again? Is it what the market was?

Mr. FETTEROLF. Yes, Senator. In essence, the term "market out" refers to the contract, itself, between the buyer and the seller. The buyer had originally agreed to pay the high NGPA ceiling. As the market fell apart, they said, "We need to market out"——

Senator DECONCINI. Pay the market price?

Mr. FETTEROLF [continuing]. And get down to the real value of this gas." Yes, sir.

Senator DECONCINI. Considerably less than the NGPA?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. Were special provisions made in the act, nonetheless, to preserve major portion analysis for Indian leases in the valuation of natural gas?

Mr. FETTEROLF. Yes, sir. Because that is a proponent of the lease, itself, the contract with the lessor, that was held out and not touched at all.

Mr. BALLEN. Now, sir, what did the committee find regarding NTL-5 in the responses to the subpoenas and other items?

Mr. FETTEROLF. We found that most of the companies viewed this act as a carte blanche sanction of their using their gross sales proceeds for Indian royalty value.

Mr. BALLEN. But that's not right, is it?

Mr. FETTEROLF. No, sir, because of the majority price analysis. But they used it as an excuse, if you will, to return to—in fact, it is not a return. Many of the companies have never attempted to

comply with NTL–5. They had always paid on their gross proceeds and disregarded the requirement to go to these ceiling prices.

However, they simply now had a sanction, if you will, or they felt like they did, to now report and use their proceeds as the basis.

Mr. BALLEN. Now, in this regard, would the biggest underpayment have occurred during the period from 1979 to 1982?

Mr. FETTEROLF. Yes, sir. That was the period in which we had the highest level of gas production in the country, and the prices also were higher than at any time previously or since.

Mr. BALLEN. Now, sir, was dual accounting a problem that the committee uncovered? We heard testimony about dual accounting this morning from the Southern Ute Tribe. Was that a problem that was uncovered?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. And could you briefly explain that?

Mr. FETTEROLF. Once again, dual accounting only comes into play when the gas produced is processed; that is, when the liquids entrained in the gas—butanes, pantanes, and propanes—individual components of that gas are stripped off by means of a plant—a processing plant that does that. Once those liquids are stripped off, there is a dry gas—that's the term, it is very dry now—at the tailgate of the plant.

Well, there are two markets now. You've got a market going on for your liquid products—butane and propane—and a separate market for that residue gas, all of this, as opposed to a sale at the wellhead without processing.

The dual accounting requirement tells the operator or lessee that he must look to both of those valuation scenarios; that is, what is this gas worth unprocessed at the wellhead? And, secondly, what is this gas worth when you consider all of the entrained liquids as a separate commodity and the residue gas stream?

In that scenario, the MMS allows a processing allowance. In other words, they allow the lessee to deduct some percentage of those processing plant costs. When it is processed through a plant they are allowed up to 66⅔ percent of the value of those products as an allowance for the cost of processing.

Mr. BALLEN. You described the situation, but do companies perform that dual accounting to ensure that the royalties are properly paid on the processed gas? If I understand it, processed gas is about 3 percent of the Indian royalty universe?

Mr. FETTEROLF. Yes.

Mr. BALLEN. Where this is a problem it is a large problem, but it is not a problem across the board; is that correct?

Mr. FETTEROLF. Exactly. We determined that, as you said, it is less than 3 percent of all Indian gasses processed; however, as you heard from the Wind River Tribe this morning, where there are Tribes that have processed gas, it is a major issue.

Mr. BALLEN. Very good, sir.

Now, did the committee also make findings in the areas of deductions or allowances taken by the companies?

Mr. FETTEROLF. Yes, we did.

Mr. BALLEN. And deductions and allowances, as we heard this morning, could be anything from transportation charges and other

kinds of charges that the companies would take off the royalty basis or value which they were paying; is that correct?

Mr. FETTEROLF. That's correct.

Mr. BALLEN. And what types of deductions?

Mr. FETTEROLF. We identified—again, from the companies' own responses—the following types of deductions or allowances that could be taken by them on Indian royalty products. Those are: production taxes levied by state and county governments; transportation allowances and deductions for moving the oil from the lease site to a market; gathering charges, which is a catch-all phrase for virtually any means by which oil and gas is gathered on the lease, put in a central point to be measured and shipped. Gathering charges are generally on a cents per barrel or per MCF charge.

We also found—and this is something that I had interjected into the interrogatories from my personal experience. Oftentimes the companies will go ahead and take such things as administrative overhead, things that maybe don't necessarily belong in the lessor's computation of royalty. Those are the basic allowances that we found.

Mr. BALLEN. What is their impact—the taking of these deductions and allowances—on the money that is going to the Indian royalty owners?

Mr. FETTEROLF. As was pointed out this morning, each of these types of deductions has some requirement for prior approval from MMS.

The first thing we found was that a good half of the companies we talked to had either not solicited that approval or, if they had, they were still taking deductions that may or may not have been in line with the approval.

This was a surprise area for us, and I think it was one area where we had the—because they were under oath, we had many of our respondents own up to some missing royalties along these lines that had yet to be uncovered by MMS or anyone else.

Mr. BALLEN. Specifically, sir, did the committee make any finding as to whether companies were improperly withholding state production taxes from the computation of their Indian royalties?

Mr. FETTEROLF. Yes, sir, we did. Most of the companies told us about production taxes that had been withheld by them from both allottees and tribes.

There is one exception to all of the subject on state production taxes. The Five Civilized Tribes in Oklahoma are not exempt from those taxes. Their royalties are taxed appropriately. Without exception, we did have many companies tell us—in fact, they told us in total of $1,100,000 that they had taken in production tax deduction without prior approval from MMS.

Mr. BALLEN. Would another major area be the transportation deductions taken? Was that a significant finding of the committee, too?

Mr. FETTEROLF. It was. We found that, again, for the question of "Have you received approval or sought approval for taking a transportation allowance," again, a good half of the companies we visited with had not sought approval.

However, I must say that the MMS has put out more notices to lessees. Now they are called "Dear Payor letters," that, in essence, laid out the requirements for asking for and obtaining approval.

What MMS did, in essence, was say, "If you're using a posted price for oil to value, and it already has a transportation deduction worked into that price that is posted, that's okay."

I think many of the tribes we visited with would take issue with that. That's a carte blanche approval.

Mr. BALLEN. I understand, Mr. Fetterolf.

Turning to another area, did the committee seek to learn the companies' view on MMS' audit program?

Mr. FETTEROLF. Yes, we did.

Mr. BALLEN. And did the committee also seek to learn the companies' view on MMS' regulations and, in general, their operating environment on Indian land?

Mr. FETTEROLF. Yes, Mr. Ballen. We felt it appropriate that we give the companies an opportunity to comment on both of those issues.

Mr. BALLEN. If you can, summarize the response of the companies to us.

Mr. FETTEROLF. First of all, in the area of auditing, the companies were adamant about one issue, and that I will term "self-auditing."

What happened many times—and has happened, and continues to go on—the MMS performs an audit, and they do it, as we have heard, on a sample of leases in a company. They may find a problem—be it valuation, gathering, transportation, whatever.

When they find a problem on their sampled leases, in the past the MMS has then instructed the company to perform a review of its own records and own up to any other incident across all the Indian leases where they have also taken the same deduction.

As a rule, most of the companies have been unwilling, and most of them flatly said, "We will not do this."

Mr. BALLEN. What other comments did the companies convey?

Mr. FETTEROLF. We asked the companies this question: "Tell us if you feel that the MMS has provided you with adequate guidelines with which to perform the analysis required to assure proper valuation of Indian royalties. Second, have those guidelines been consistently applied to your company by the MMS?"

Not surprisingly, 7 of the 19 companies that we asked that question of emphatically said no to both questions. We have not received adequate guidelines, and we have been victimized by inconsistent application of those guidelines.

It was not unusual for us to find that those companies that said no are also the same companies that, in the past, have had litigation, have had audit findings on them, and have taken interpretive views their way on issues that are subject to interpretation.

Some of the things that the companies said were well taken. For example, the companies suggested first that the Indian lease is a contract, after all, and a contract clearly lays out the responsibilities of both parties.

Many of the companies suggested that with these concepts of majority pricing, of specialness, of an attempt to maximize the Indian

royalty, they've left the tenets of the contract and left the fairness of a mutually agreed to relationship that the contract defines.

Frankly, they said in essence, if the Indians want to be in this business, then they should own up to their contract terms.

Many of the companies were adamant about this and went so far as to say that the existing and, to their mind, burdensome regulations involved, and several other problems that, to their mind, they have endured from having Indian lands, are rapidly having a "chilling effect," to quote them, on their willingness in the future to lease and seek out Indian lands for production.

Mr. BALLEN. So they spoke to some disincentives that they view they have.

Let me ask you this question. We heard from Mr. Gover from the Wind River Tribe and the other Tribes this morning about the latest developments in the law that would, in effect, allow double taxation both by Indians and states. How would that affect or add up to the disincentives that the companies are experiencing?

Mr. FETTEROLF. Many companies expressly stated that this area was definitely a disincentive, and that given the option of leasing Indian lands carrying as much as 28 percent burden for tax, as was pointed out, may lead them to go to the rancher's land next door, seek out state lands, other places where these burdens are not upon them.

Mr. BALLEN. It is important for future Indian mineral development that these issues are resolved so that the disincentives, such as they are, do not result in this chilling effect.

Mr. FETTEROLF. That's correct. And, in addition to the tax issue, some of the companies told us that because of the requirements of leaving their normal accounting stream and having to go and seek out values and make sure that their Indian royalty basis is proper and in accordance with the NTLs, and the lease terms, this added burden costs them money to do this. As I said earlier, most of them don't even feel that they can do it or should have to do it.

Mr. BALLEN. In fact, most of them don't do it, though, so it is somewhat—and the argument is that it costs more; yet, at the same time, we were finding that a lot of them weren't doing it at all.

Mr. FETTEROLF. That's true.

One other issue they talked about, too, was that because of their exposure on interpretive issues, on things that can be interpreted either way and they've chosen to interpret them their way, because of that exposure, especially in early periods of the 1980s, for example, plus the consideration of interest and payment on underpayments that MMS may decide interpretively are due, that adds another burden and that has another exposure for them that they must consider when they go out to lease new lands.

Mr. BALLEN. Now, Mr. Fetterolf, throughout this testimony you have indicated a number of reasons why companies may be underpaying royalties owed to Indian mineral owners. These reasons include: the failure to perform certain valuation techniques, as required by law; the improper taking of certain deductions; failure to comply with NTL–5, among numerous other reasons.

Has the committee been able to estimate an amount of Indian royalty potential underpayment from the data and answers sup-

plied by the companies who were selected by the committee to respond?

Mr. FETTEROLF. Yes, sir, we have.

Mr. BALLEN. And is that amount of money that we have been able to estimate divided into two periods of time?

Mr. FETTEROLF. Yes, Mr. Ballen. We felt it appropriate to look at two time frames of equal time, those being 1978 through 1982, and 1983 through 1988. There are many, many differences between those two periods, many of which have already been pointed out.

I'd like to say that the committee, itself, is somewhat hesitant to put forth numbers that are really estimates. I, myself, personally sat in this very room in 1982 and testified on behalf of the State of Wyoming and I was asked the same question at that time: how much do you think is out there?

I'm in a much better position, having gone through the analysis of the committee and the work we've done now, to say that on Indian land; however, I would caution that in the period of 1978 to 1982 there was a total of $600 million collected by USGS. That was total Indian revenues of all kinds associated with minerals. Keep that in mind—$600 million total.

We found that we have come up with an estimate for that period, 1978 through 1982—and I have many reasons. I would really like to say those reasons. But we found in that period, we estimate between $25 million and $60 million has been lost, has been potentially underpaid, in that five-year period from 1978 to 1982.

Mr. BALLEN. Mr. Fetterolf, let me just understand something when you're talking about these numbers. You say "potentially." You say that because these are interpretive issues where the company has a point of view and presumably the protection of the Indians is another point of view?

Mr. FETTEROLF. That's correct. You must also remember that in that time frame we experienced in this country the highest production levels and the highest prices obtained for both oil and gas, so naturally in that period when prices are higher and the volumes are higher, your exposure to underpayment is going to be higher.

As you mentioned, interpretive issues in that period were just as loose as they could be. There was no MMS in place. No Minerals Management Service was created until 1982. No entity was dedicated with its sole purpose to watching that store. So there was very little audit effort going on at that time.

One thing that I haven't heard yet in any testimony is a speaking to the accounting errors that are rampant in this industry. It is a very complicated industry—especially in the area of accounting for natural gas. There are only two universities in the country that offer any kind of mineral accounting degree, and it is a very complex and complicated area.

The errors made by the companies in this period—and there are many that have been uncovered to date—again, the companies, themselves, were so busy finding, producing, and selling oil and gas that they often didn't have time to do a proper accounting in-house. So there is a lot of accounting error in this period.

We would say that you heard about—again, we heard about real theft earlier in the week. We heard a discussion today about something called "legal theft" or "paper theft." We would suggest that

these numbers we are putting forth today were primarily unintentional and do not fall into either of those categories.

Mr. BALLEN. Sir, what was the total amount of money again?

Mr. FETTEROLF. It was $25 million to $60 million, which is 5 to 10 percent of the total mineral monies collected in that period.

Mr. BALLEN. Now, let me ask you this question: you say we have identified this potential underpayment of $25 million to $60 million in that time period of 1978 to 1982. Are those funds collectible now?

Mr. FETTEROLF. That's a very good question, Mr. Ballen. They may not be, in fact, because most of the companies do not even have the records associated with those sales, especially in the late 1970s. Also, because there are serious questions about the statues of limitations, one other item is that many of the companies paying royalties in that time are bankrupt now. These were run and gun guys who came up when things were good, started a small company, went out and leased Indian lands or federal lands, and made a good show of things for a couple of years but, in fact, had very little substance as a corporate entity and are belly up. They may not be locatable, or we may be unable to collect from those entities.

Mr. BALLEN. Now, sir, did the committee also estimate the total potential underpayment for the period of 1983 to 1988?

Mr. FETTEROLF. Yes, sir, we did.

Mr. BALLEN. And what is your estimate for that period? Can you give me the range and the source of the data?

Mr. FETTEROLF. Yes, sir. Again, we would qualify these estimates. However, in that time frame, 1983 to 1988, we would estimate a potential underpayment of royalties on the order of $10 million to $25 million.

I'd like to add that the committee, itself, in this time frame, because of our questions to the companies, managed to identify between $300,000 and $500,000 of potential underpayments—probably very high potential underpayments, since the companies, themselves, were telling us about them—that have never been uncovered by the MMS.

But that $10 million to $25 million we feel is a good estimate for that period.

Mr. BALLEN. Can I ask you this: was there an amount of money that the companies, by being placed under oath and required to submit to subpoenas, themselves admitted to as a potential number in this?

Mr. FETTEROLF. Yes, sir.

Mr. BALLEN. What was that number?

Mr. FETTEROLF. That number was $5.6 million that the companies, themselves, told us are out there.

Mr. BALLEN. Now, go ahead with how you arrived at the $10 million to $25 million figure.

Mr. FETTEROLF. I would first like to speak to the fact that the number, compared to the number we have estimated for the 1978 to 1982 period, is significantly reduced for a number of reasons. Primary among those was the creation of MMS, one entity dedicated to watching this store.

In the period 1983 to 1988 we saw MMS start their audit programs, build them up, and, to whatever degree audits have been performed, they occurred in that period primarily.

One other feature is the new PAAS system in MMS that is going to compare reported sales on volume and quality to one entity with reported sales coming in on royalty. It is an excellent control, and was not available prior to this period we're talking about.

One other major consideration for our reduced estimate in this period is that many of the big-dollar issues that are involved in natural gas, for example—and these are, again, vernacular, but advance payments from buyers and somewhat more esoteric considerations have been resolved either through litigation or through the promulgation of rules or appeal outcomes at MMS.

These big-dollar issues have generally been resolved and take away the potential for Indian royalties that are associated with those issues.

One other area that should be evident to everybody after this morning, the tribes have begun to watch their own store. Those tribes that are sophisticated enough and have taken upon themselves to spend the time, energy, and money—which is considerable—to watch their own store have begun to do so. They began to do that in the mid 1980s. At present, many of them are capable of minding that store and making comparisons—primarily those that have a production tax now. That is excellent data. That is an independent source of data from the same company that they can use to compare to the data they're getting from MMS and pop exceptions and pop undervalues.

As I mentioned, in this period of 1983 to 1988 we had a lot more direct watching of that store by the lessor, himself.

Finally, the market for oil and gas in the 1983 to 1988 period, as opposed to the earlier period, has stabilized. You can't get much more than $20 for a barrel of oil out there anywhere, regardless of its quality or even how easy it is to produce and get to a market. You also can't get much more than $2.50 to $3 for 1,000 cubic feet of gas.

You will find that the disparities among arm's length sales out there are getting closer and closer, and they will eventually, I presume, be almost nothing.

So the price for oil and gas has nearly stabilized in this period, and there is a lot less at stake for majority price analysis, for example.

Mr. BALLEN. Nonetheless, though, there is still a substantial amount of underpayment out there—potential underpayment?

Mr. FETTEROLF. Yes, sir. In my experience as an oil and gas auditor, I have found that you could have one well that is a good producing well, and if it is a gas well, if you go in and it has never been audited, and look at five years, and it has had a lot of production at a decent price and something is wrong value-wise, you can roll up a large sum of money in a very short time on just one well.

You heard this morning some of the tribes tell us about some large dollar figures that they have identified and asked for. You will hear more tomorrow and today from individual allottees who have had audits performed or done them themselves, and they also

will probably astound you with some of the numbers they are going to put forth on those individual, specific cases.

Because the committee was unable to perform actual audits of any individual lease, we were forced to look at things from an overview. I must say that, again, on the specific case, if it is a good producer and you've got a big problem, you can roll up some real money real fast—especially when you throw 18 percent interest on that, which is the current statutory interest.

Mr. BALLEN. Mr. Fetterolf, thank you very much.

I should point out for the record that there is a lot of additional detail and findings that you have uncovered and the committee has uncovered in this area that will be made part of the report, and that today you are just presenting a brief overview of what was an extremely extensive and time-intensive task; is that correct, sir?

Mr. FETTEROLF. That is correct, sir.

Mr. BALLEN. Thank you very much.

Mr. Chairman?

Senator DECONCINI. Mr. Fetterolf, thank you for that background and detail.

Let me ask a question here: are these procedures that are used on Indian accounting and the majority price analysis and the allowances and the dual accounting used any place else in the industry?

Mr. FETTEROLF. Actually, Senator, early on it was also construed that the public lands were supposed to be subjected to the same kind of analysis. In fact, since that time, through attrition, mostly, and through acts of MMS, now public lands are considered—the gross proceeds that the company is realizing is now the basis for those royalties.

Senator DECONCINI. And, of course, that is the basis that the industry uses on private lands, too. If I own some land and had it leased, or if a charity owned some land and had it leased, or some other company, that's what they would use?

Mr. FETTEROLF. That's correct, Senator.

Senator DECONCINI. Did you indicate—I want to be sure I have this right—that the companies agreed to pay up a certain amount between $5 million and $6 million, or they agreed that that was an amount that was lost?

Mr. FETTEROLF. In truth——

Senator DECONCINI. During 1978 to 1982, I think.

Mr. FETTEROLF. No, sir. Our period was 1983 to 1988. That $5.6 million was for the more recent period.

Senator DECONCINI. I'm sorry. From 1983 to 1988.

Mr. FETTEROLF. In the way we couched our questions, really, we said, "Company A, what is your exposure to these various issues? And define that exposure in terms of dollars for us on Indian lands. In other words, how much do you think you might owe if you did have to perform majority price analysis across your Indian lands? How much might you owe for unauthorized transportation deductions, for example? How much money do you currently have in litigation on Indian lands that may or may not be collected ultimately, pending the outcome of that litigation?"

It is there that they told us collectively $5 million to $6 million we would look toward.

Senator DECONCINI. Mr. Ballen?

Mr. BALLEN. Of course, Mr. Fetterolf, we can't say this is the entire Indian lease universe because we subpoenaed only selected companies and questioned selected companies; is that correct?

Mr. FETTEROLF. That's a good point, Mr. Ballen. We tried our best to cover a majority and tried to cover geographically, and because of our attempts to make sure we were looking at things that we could call endemic to all Indian lands, we may have left out some companies. Frankly, we may have left out some smaller independent companies that may have a propensity to underpay.

Senator DECONCINI. Senator McCain, do you have any questions?

Senator MCCAIN. No thank you, Mr. Chairman. But I would like to thank both members of the staff for the very exhaustive and very informative job that they've done. Thank you.

Mr. FETTEROLF. Thank you, Senator.

Senator DECONCINI. Mr. Fetterolf, thank you very much.

Before we go to Mr. Norman, Senator McCain and myself, on behalf of the committee, and Senator Daschle, would like to announce that some preliminary findings may provide to the Navajo Nation as much as $5 million in additional tax revenue. This announcement should be taken with some caution. We are not auditors, per se, nor were we specifically looking for any sums as part of any of our audit for refunds to anybody; we were looking for the problem to identify it. However, in the course of our investigations, the committee has discovered what appears to be an error in the computation of the Navajo possessory interest tax, a tax imposed by the tribe on oil and gas companies. In computing the tax over an eight-year period, the companies may have been given an allowance for the State production taxes, which was intended to but did not accurately reflect the percentage of State taxes actually paid.

As a result, the possessory interest tax may have been lowered over the period in an amount which could reach as much as $5 million.

Additionally, corrections of the error would yield significant additional tax procedures for the future, of course.

Let me make it very clear by this announcement that we have found no evidence that the oil companies involved here intentionally misstated the amount of the taxes paid, or even that the oil companies were the source of possible misinformation.

We have recently alerted the Tribe to this preliminary finding, and have committed an offer to work with them to help them collect any taxes owed. We are very delighted with this information, and if anybody wants some more information on it they can talk to the attorney on the committee, Mr. Klingenstein, who is to my right here, who will be more than happy to go into some of the details of what we have.

Mr. Ballen, are you ready for Mr. Norman?

Mr. BALLEN. Thank you, Mr. Chairman.

Senator DECONCINI. Excuse me, please. Did you have anything you wanted to add, Senator McCain?

Senator MCCAIN. Not at this time. Thank you.

STATEMENT OF CHARLES A. NORMAN, ACCOUNTANT, SPECIAL COMMITTEE ON INVESTIGATIONS

Mr. BALLEN. Mr. Norman, did you engage with Mr. Fetterolf in an assessment based upon the documents that were subpoenaed and questions put to the companies and otherwise to assess the effectiveness of the Minerals Management Service in the performance of its royalty collection function?

Mr. NORMAN. Yes, sir.

Mr BALLEN. And, again, could you describe the MMS briefly and what it is supposed to do in terms of collecting and ensuring the proper payment of royalties to Indian interest holders?

Mr. NORMAN. Mr. Ballen, let me precede that with a very brief overview of the MMS and the four divisions specifically that we examined in detail. Those divisions include: the Fiscal Accounting Division; the Royalty Compliance Division; the Royalty Valuation and Standards Division; and the Production, Accounting, and Auditing Division.

Our examination of them has occurred over the life of the committee, and we have examined thousands of documents on site and interviewed their personnel in order to reach our conclusions.

Mr. BALLEN. Now, Mr. Norman, did you examine each of those entities, and did the committee examine each of those entities—Royalty Compliance; Royalty Valuation and Standards; Fiscal Accounting Division; and Production, Accounting, and Auditing Division?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. Now, you testified you met with various MMS personnel throughout the course of the nine months?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. And, in fact, they were kind enough to give you an office on site in Lakewood, Colorado, at their headquarters to spend a lot of time with them questioning and examining records?

Mr. NORMAN. That's correct, Mr. Ballen.

Mr. BALLEN. Now, in conducting your review and the committee's review, did you have access to the documents and sworn responses referred to earlier in Mr. Fetterolf's testimony?

Mr. NORMAN. Yes, sir, I did.

Mr. BALLEN. And did you meet with all the participants and representative participants in the royalty universe, so to speak?

Mr. NORMAN. Yes, sir. That would include, of course, Indian mineral owners, industry—that includes companies, industry trade groups, and, of course, the Department of Interior personnel.

Mr. BALLEN. Now, in fact, did the committee also conduct an independent survey of Indian Tribes having mineral interests?

Mr. NORMAN. Yes, sir, we did. That included data on mineral resources on Indian lands, Indian severance tax systems, and generally their experience in relationship with the Minerals Management Service.

Mr. BALLEN. And did the committee also thoroughly depose the Minerals Management Service, as well as placing industry under oath, as Mr. Fetterolf previously testified to?

Mr. NORMAN. Yes, sir, that did occur.

Mr. BALLEN. Now, what conclusions from your review of the documents, the interviews, and sworn testimony taken, did you arrive at with respect to the Minerals Management Service?

Mr. NORMAN. Well, broadly speaking—we'll get into some serious problems that remain soon. However, MMS is clearly the best of the three DOI agencies responsible for Indian mineral administration.

We have heard recently about the abysmal record of the Bureau of Land Management. The BIA's performance was profiled at the last set of hearings, and MMS—again, problems remain that we will discuss, but it is clearly a model of efficiency compared to the other two agencies.

They also have a serious philosophical problem, and by that I mean that MMS' budget depends to some degree on the amount of money they collect, so they have a natural motivation to spend their time in those areas that generate the most revenue and the most recovery. Those mineral areas generally include the Gulf of Mexico oil and gas production, which accounts for most of the federal and Indian revenue as the total. So there is a natural inclination to spend their time in that area to the exclusion of Indian oil and gas leases.

One of the reasons that occurs is because there is simply not a clear definition of the trust responsibility. If Congress would clarify that it would go a long way toward resolving a controversy that has been around for a very, very long time.

Mr. BALLEN. Mr. Norman, one of the significant problem areas that remain with respect to MMS is the protection of the allottee interest—individual Indian allottees?

Mr. NORMAN. Certainly that is a problem that is going to require a lot of study, because allottees typically are on their own, simply stated, and they don't have the clout of the tribe and, many times, the expertise or representation. So they do require some special attention.

Mr. BALLEN. And they have suffered greatly in this process?

Mr. NORMAN. No question about that.

Mr. BALLEN. What are the improvements that the MMS has instituted since its early days when it seems to be generally recognized it was a floundering agency?

Mr. NORMAN. In the past few years they have definitely done a better job of collecting and promptly distributing the money to the Bureau of Indian Affairs, and they have added a significant number of additional audit staff. Finally, there have been some significant accounting system improvements.

Mr. BALLEN. Now, you did state earlier, though, despite MMS' relative improvement and their relative standing in relation to the job that BLM and BIA have done, that there are very significant problems that still remain. Would that be fair?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. Are some of those problems in MMS' accounting system?

Mr. BALLEN. Yes, sir, that's correct. The accounting system, as it exists today, simply doesn't flag most potential underpayments, and it doesn't identify potential audit candidates.

Mr. BALLEN. What does the MMS system fail to catch, sir?

Mr. NORMAN. Well, the same items that we have heard discussed today and mentioned by the Southern Utes, the Northern Utes, and Mr. Fetterolf, and that includes, generally speaking: improper valuation issues and improper or excessive deductions from the royalty basis.

Mr. BALLEN. In other words, their accounting system doesn't catch these items as the checks and the forms first go in from the companies; is that correct?

Mr. NORMAN. It does not catch those items, and it does not detect unusual relationships that should give rise to more study.

Mr. BALLEN. How about arithmetical errors? Suppose I'm filling out these forms with my royalty check and make an error on it? Does the MMS accounting system and computers pick that up?

Mr. NORMAN. This sounds funny, but the MMS doesn't know.

Mr. BALLEN. They don't know?

Mr. NORMAN. They don't know.

Mr. BALLEN. When we took their deposition what did they say?

Mr. NORMAN. They said they're not sure.

Mr. BALLEN. So they're not sure whether their system picks up arithmetical errors?

Mr. NORMAN. That's correct, sir.

Mr. BALLEN. Can their system be changed to catch these kinds of errors that we're talking about—arithmetical and the deductions and valuation problems that have been identified by Mr. Fetterolf?

Mr. NORMAN. Well, assuming the arithmetic checks aren't in place, it shouldn't require, one would think, a great deal to make it add and subtract. The other——

Mr. BALLEN. All this kind of processing is done by computers?

Mr. NORMAN. Yes, sir. That's correct. With the other items—detecting improper valuation and deductions—of course, you'd have to weigh the cost and relative benefits of implementing that.

Mr. BALLEN. Because it obviously costs money to implement that kind of computer programming operation?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. So I can understand this and so that the members of the committee can, compare it for a moment to IRS. With IRS, if I understand it correctly, we all submit our taxes, we fill out a form and a check goes into IRS, which is the same as what is done in the MMS process. The companies fill out a form and send in a check. In the IRS system, what do they do? They flag for a potential audit, and they also identify problems, don't they, right up front?

Mr. NORMAN. They have a very—based on the statistical history they have compiled, they have a very good set of reasonableness tests that allow them to choose, on a selective basis, as many people in this room know, returns that deserve some more attention. And, in that way, they are able to concentrate on those items that have potential for dollar recovery. And, of course, as I have mentioned, the MMS system does not have that capability.

Mr. BALLEN. I guess in the IRS system, for example, if you put a home office deduction on your return they tend to audit those because the computer picks those up. In other words, the MMS doesn't have a comparable kind of system that says with transpor-

tation deductions or excessive ones we're going to flag this and audit this person?

Mr. NORMAN. No, sir.

Mr. BALLEN. Now, if MMS doesn't have built into its accounting system these kinds of checks and flagging of potential audit candidates, as well as identifying potential underpayments, what does the MMS do to ensure that the Indian leaseholders are getting their proper amount of royalties?

Mr. NORMAN. MMS relies on two tools: it performs audits and imposes penalties.

Mr. BALLEN. Again, the penalties are—these are things the IRS does, too. It can audit you, and if you're not paying your taxes it imposes penalties; correct?

Mr. NORMAN. That's correct.

Mr. BALLEN. Now, what are the problems the committee has found with the auditing function of the MMS?

Mr. NORMAN. Well, the biggest problem is that they've been very slow in implementing that function. Mr. Fetterolf profiled them very briefly in his presentation. They came into being in about 1982. In those early years, two things happened to the detriment of Indian royalties. And keep in mind, as Mr. Fetterolf pointed out, these were the big years. In that 1978 to 1982 period I believe he mentioned a figure of $600 million in Indian mineral revenues.

A couple of things happened. Number one, MMS auditors were pre-occupied with a number of non-auditing issues in getting the MMS system up and running, so there wasn't a lot of auditing of any kind occurring.

Secondly, as I mentioned, there is a natural predisposition toward the large leases—the Gulf of Mexico, the off-shore leases, and, of course, there aren't any Indian royalty owners out there.

So those are the things that happened in the early years and, in fact, to some extent have carried over until fairly recently. There has been very slow implementation. In fact, a full-scale audit effort, in my judgment, didn't begin until about 1986.

Mr. BALLEN. So they missed some of the years. Did this delay by MMS result in an appreciable harm to Indian interest?

Mr. NORMAN. There is no doubt about it. A couple of things have happened. There is extreme pressure now to complete—as the Southern Utes, I believe, mentioned this morning—ongoing audits from those early years. And, in fact, I believe the former Assistant Secretary for Land and Minerals accelerated the completion date of those early years, and that's not good news for Indian mineral royalty owners.

Secondly, there is a significant issue as we speak about the issue of record retention from those early years. Again, that has nothing but down-side potential for Indians.

Mr. BALLEN. Turn to the enforcement area. Did you assess the effectiveness of the MMS penalty system?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. And how did you make that assessment, sir?

Mr. NORMAN. We studied the MMS records, we reviewed the documents that we assembled and procured from others, and we consulted outside experts on this subject.

Mr. BALLEN. And what did you conclude, sir?

Mr. NORMAN. We concluded there is a very serious problem with enforcement of the FOGRMA provisions.

Mr. BALLEN. FOGRMA is the 1982 Federal Oil and Gas Royalty Management Act?

Mr. NORMAN. That's correct, Mr. Ballen.

Mr. BALLEN. And there is a very serious problem with MMS' penalty system. What is it?

Mr. NORMAN. They're not imposing penalties.

Senator DECONCINI. Do they have the information to impose the penalties?

Mr. NORMAN. Yes. I think we'll flush that out for you, Senator.

Senator DECONCINI. Okay.

Mr. BALLEN. Well, how many times have they imposed penalties, what has been the nature, and how much penalty has been paid? We can lay this out.

Mr. NORMAN. Here is the story. In the last seven years, the news is that they've collected about $74,000 in penalties in that entire period, and that's—I don't have with me the total amount of revenue they collected. I think it is around $4.5 billion to $5 billion annually—federal and Indian.

Mr. BALLEN. And how many instances of actually assessing penalties were there in seven years, sir?

Mr. NORMAN. There have been 35 instances where penalties have been imposed. There are——

Mr. BALLEN. How many on Indian lands?

Mr. NORMAN [continuing]. Five instances where those penalties were actually collected.

Mr. BALLEN. Five out of the 35?

Mr. NORMAN. That's correct.

Mr. BALLEN. How many on Indian land?

Mr. NORMAN. Zero.

Mr. BALLEN. And in how many instances where penalties were even imposed was the penalty paid zero—no penalty?

Mr. NORMAN. Well, to date I guess it would be 30. There are still some penalties outstanding that haven't been resolved.

Mr. BALLEN. Let me ask you that. How can you impose a penalty and not have money paid to you? When the IRS imposes a penalty you have to pay the money, right?

Mr. NORMAN. Yes, sir.

Mr. BALLEN. Why is it in the MMS system you don't have to pay when a penalty is imposed?

Mr. NORMAN. There is a loophole in FOGRMA——

Mr. BALLEN. Which is the law governing MMS?

Mr. NORMAN. Yes, sir—that really needs some Congressional attention to fix. Simply stated, there is a loop hole that allows a cure period for penalties that MMS deems to be unintentional. The practical effect of that is that penalties always get cured. So that is why we have these statistics today.

Senator DECONCINI. What do you mean they always get cured?

Mr. NORMAN. The notice is sent out, and if MMS concludes that that infraction was unintentional, Senator DeConcini, then they have the ability to permit the company, within a certain timeframe, to correct the problem. If they do that, the penalty is abated.

Mr. BALLEN. So where is it—if they do that, where is the incentive in this system to comply with—you do something wrong, and you just wait and pay it. What do you lose?

Mr. NORMAN. That's a good question, Mr. Ballen.

Senator DECONCINI. The longer you wait, there is no further penalty for that waiting, right?

Mr. NORMAN. No, sir.

Mr. BALLEN. This is not the way the IRS collects taxes, is it?

Mr. NORMAN. It has not been my experience with the IRS.

Mr. BALLEN. Or mine. [Laughter.]

Mr. KLINGENSTEIN. Mr. Norman, is it correct that, based on the information we were provided by MMS, in at least 17 instances, or almost half of the 35 where penalties were initiated, this cure period was availed by the companies, and so no dollars were paid?

Mr. NORMAN. That's correct, Mr. Klingenstein.

Mr. KLINGENSTEIN. And then you mentioned there are five occasions where a small amount of money over that period— $73,000 or so—has actually been collected?

Mr. NORMAN. Yes, sir.

Mr. KLINGENSTEIN. And the remaining times those penalties are unresolved?

Mr. NORMAN. Yes, sir.

Mr. KLINGENSTEIN. On appeal, etc.?

Mr. NORMAN. That's correct.

Mr. KLINGENSTEIN. Mr. Norman, do you know whether other committees or other entities who performed investigations in this area have likewise noted a problem with the penalty system?

Mr. NORMAN. Yes, sir, I believe the Yates Committee in 1985 or 1986, and the General Accounting Office in about the same period, both studied this issue.

Mr. KLINGENSTEIN. And they concluded that the penalty enforcement system was deficient?

Mr. NORMAN. Yes, sir.

Mr. KLINGENSTEIN. So this is a problem of some longstanding?

Mr. NORMAN. That's absolutely correct.

Mr. BALLEN. And nothing has been done to change it, has it?

Mr. NORMAN. No.

Mr. BALLEN. Have we consulted experts who have given us their opinion of the MMS penalty system as compared to the IRS? I guess you don't need an expert to know that if you're not going to get a penalty for not paying the money, there's not very much incentive to pay the money. But, nevertheless, what did the experts tell us?

Mr. NORMAN. We consulted one anyway, and I'll summarize his response to us. Mr. Kent Smith, a Harvard Ph.D., presently residing at the American Bar Foundation, in response to this query, concluded or commented that "Penalties are an essential component of any effective enforcement strategy. They are the lynch pin on which the rest of the enforcement structure relies. And yet it is clear, from the various estimates available, that non-compliance with FOGRMA is both widespread and sizable. It is also clear that penalties are only infrequently being imposed. Currently, there is an enforcement problem that needs careful study, leading probably to extensive reforms."

Finally, he sums up by saying, "My preliminary reading of the materials you have provided lead me to believe that there is a very large noncompliance problem that is not being effectively addressed by the current penalties in MMS' enforcement procedures."

Mr. BALLEN. Mr. Chairman, I'd like the statement of the expert to be submitted in full in the record.

Senator DECONCINI. Without objection.

Mr. BALLEN. Now, there are other tools the IRS and other agencies who collect money like to use to make sure they get the money, such as awards. How does that work with MMS?

Mr. NORMAN. I believe FOGRMA has a reward provision; however, it is, as with penalties—in fact, it is utilized even less. I have not found that any rewards under FOGRMA have been paid to date.

Mr. BALLEN. When you say a reward, what do you mean by a reward or award?

Mr. NORMAN. I mean it is a whistle-blower statute that allows people to bring forth to the Department of the Interior infractions or serious violations of MMS. In exchange for that information, if it is successful in collecting funds, that whistle-blower is granted a reward.

Mr. BALLEN. Has this been used at all?

Mr. NORMAN. I don't think so. No.

Mr. BALLEN. Does it even apply to Indians?

Mr. NORMAN. No.

Mr. BALLEN. Mr. Klingenstein, did you want to add something?

Mr. KLINGENSTEIN. This is a system that allows company employees up to ten percent of the underpayment collected as an incentive to provide this information?

Mr. BALLEN. Thank you for that clarification. That's correct.

Mr. KLINGENSTEIN. And IRS has comparable reward provisions that it uses?

Mr. BALLEN. Yes, sir.

Mr. BALLEN. Now, this committee had subpoena power to go out and collect, as we know, large volumes of records. How about the MMS? Do they have subpoena power? Do they use it in the area of enforcement?

Mr. NORMAN. Our conclusion is that they are reluctant to use their subpoena power. They do possess that power, Mr. Ballen.

Mr. BALLEN. But in our review they have not used it extensively? Indeed, not as extensively as this committee?

Mr. NORMAN. That's correct.

Mr. BALLEN. How about a failure or a penalty for companies who refuse to turn over documents? Has MMS followed up on that?

Mr. NORMAN. No, sir.

Senator DECONCINI. What would be the penalty for non-compliance with a subpoena from MMS? Do you know?

Mr. NORMAN. I'm not sure I know. I'd like to consult my assistant and we'll have an answer.

There are some liquidated monetary damages associated with that that escalate as a function of time.

Senator DECONCINI. And is it correct that they can go for contempt for failure to respond to the subpoena?

Mr. NORMAN. Ultimately I believe that's right.

Senator DECONCINI. And do you know of any instances where they have done either one of those two things?

Mr. NORMAN. I'm aware of no instances, sir.

Senator DECONCINI. Did you ask in our investigation?

Mr. NORMAN. We did ask that question.

Senator DECONCINI. Mr. Fetterolf, can you respond to that?

Mr. FETTEROLF. Senator, I seem to recall the audit chief of MMS suggesting that there were times when they wished they could or would have preferred to do that and didn't, for whatever reason, but it would have helped the auditors.

Senator DECONCINI. But it was solely their judgment not to do it?

Mr. FETTEROLF. Yes, sir.

Senator DECONCINI. Thank you.

Mr. BALLEN. Thank you.

Let me just turn to one last area of the committee's findings. Has the government made—we heard from the Tribes this morning about having agreements to help themselves rejected by the government. Has the government here, the Department of Interior, made a serious effort to help the Tribes help themselves and watch the store, as Mr. Fetterolf put it, with regards to protecting their own Indian royalty interests?

Mr. NORMAN. Well, with regard to 202 agreements—that is the joint audit agreements—there are only two Tribes that have such a funded agreement. We found in our survey that some tribes didn't know that a 202 agreement was even available.

Mr. BALLEN. Now, these 202 agreements are joint auditing agreements between MMS and the tribe; is that correct?

Mr. NORMAN. That's correct.

Mr. BALLEN. Now, in our survey we have found that some Tribes don't even know that this mechanism is available?

Mr. NORMAN. That's right.

Mr. BALLEN. So MMS has not done a very good job of informing the tribes of their abilities to get this kind of help from the government?

Mr. NORMAN. That's right.

Mr. BALLEN. Now, in addition to that, sir, is there a finding of the committee that is serious with regard to the whole system and the way the leased ownership and the Indian royalty system is set up?

Mr. NORMAN. I have an opinion about that.

Mr. BALLEN. Why don't you give it?

Mr. NORMAN. The history of the oil and gas business—any of the mineral commodities—is a cyclical one. As we all know, it is a cycle of booms and busts that have occurred over the last century, and no doubt will occur again. So the economics are very fragile, and they require quick response.

We have heard today from the Southern Utes and the Northern Utes, and there are other tribes that have the ability to react quickly given enough autonomy and the ability to handle their own mineral resources.

The Southern Utes, as an example—and there are others—emulate oil companies. In fact, they operate very much like an oil company. There is more to mineral resource management than auditing leases and collecting money. What has been done and needs to

be encouraged—and this may be the most important finding we have throughout—the Indians need to be given more incentive, more autonomy to handle this function from pre-leasing through production, as the Southern Utes have demonstrated can be done. Again, with the cyclical nature of the oil and gas business, DOI will probably never be able to react quickly enough. It is a happy elephant. It will be around when we are gone, and these problems will remain.

So if those incentives can be passed along or beefed up for Indian mineral tribes, I think that is ultimately a much better solution than trying to mold DOI to fit their needs.

Mr. BALLEN. Well, in the last boom, as a result—and we can tell by the numbers that Mr. Fetterolf and the other tribes presented here today—the Indians weren't in place with these kinds of mechanisms to allow them to reap the full reward. Right now, if the next boom comes, they're not being put in that same position to reap the rewards; is that true?

Mr. NORMAN. That's where the *Arizona Republic*'s billions are, in the opportunities lost. It is a 1982 legislation that gives Indians the power to put together some innovative agreements, and there have been some of those put together in that period. But there needs to be more done in that area, more funding, and if that process continues I think it will operate to the benefit of all Indians.

Mr. BALLEN. That concludes my portion of the questioning, Mr. Chairman.

Senator DECONCINI. does anybody else have any questions they want to follow up on?

Mr. Klingenstein?

Mr. KLINGENSTEIN. I have a couple, Mr. Chairman.

Mr. Norman, earlier you were discussing a comparison between the IRS system and that which MMS has. You said that the IRS is capable of flagging prime audit candidates, and that MMS is not, correct?

Mr. NORMAN. That's correct, Mr Klingenstein.

Mr. KLINGENSTEIN. You noted that MMS does not know whether its up-front computer system is capable of catching arithmetical errors?

Mr. NORMAN. Yes, sir. That's correct.

Mr. KLINGENSTEIN. Do you know whether the IRS system is capable of catching those errors?

Mr. NORMAN. It is capable of catching those errors.

Mr. KLINGENSTEIN. Let me ask you about the penalty system again. You noted in your testimony that there is a possible loop hole in the unintentional penalties which allow a 20-day cure period for the company. Do you know how many willful or intentional penalties the MMS has imposed? Is that number one over the course of the last seven years?

Mr. NORMAN. That's right. It is one.

Mr. KLINGENSTEIN. Do you know how many Indian payers the MMS has moved to initiate penalties against?

Mr. NORMAN. The answer to that is also one.

Mr. KLINGENSTEIN. Lastly, Mr. Norman, you mentioned at the close of your testimony the need to help Indian tribes develop their own expertise in exploring and exploiting their mineral resources.

I'm wondering whether you know if MMS currently has an office designated to serve those functions, and whether it is adequate to fill the job.

Mr. NORMAN. Are you referring to the Office of External Affairs, Mr. Klingenstein?

Mr. KLINGENSTEIN. I'm referring to the Energy and Minerals—

Mr. NORMAN. The Bureau of Indian Affairs Energy and Minerals Division in Golden, Colorado.

Mr. KLINGENSTEIN. I'm sorry. The Bureau of Indian Affairs Office.

Mr. NORMAN. Yes, sir. That office does exist. It is an office of scientists—primarily geologists and engineers. They are understaffed. They have some serious personnel and morale problems, and they are not able to meet the needs of the hundreds of thousands of Indian mineral acres out there that need to be assessed and properly developed.

Mr. KLINGENSTEIN. Thank you.

Senator DECONCINI. Thank you very much, Mr. Norman. We appreciate it.

Thank you, Mr. Fetterolf. We appreciate your very helpful testimony.

Mr. Ballen?

Mr. BALLEN. Again, Mr. Chairman, these witnesses have presented a summary of very intensive work. The full information we plan to present in the report.

Senator DECONCINI. Thank you for that clarification.

Thank you very much, gentlemen.

The next panel will be Alan Taradash, Attorney from New Mexico experienced in the oil and gas area; and Mr. Ervin Chavez, Navajo owner of allotted land in Bloomfield, New Mexico.

Ms. Mary Lou Soller will conduct the questioning.

[Witnesses sworn.]

STATEMENT OF ALAN R. TARADASH, ATTORNEY, NORDHAUS, HALTOM, TAYLOR, TARADASH & FRYE, ALBUQUERQUE, NM, EXPERIENCED OIL AND GAS ATTORNEY; AND ERVIN CHAVEZ, NAVAJO OWNER OF ALLOTTED LAND, BLOOMFIELD, NM

Ms. SOLLER. Mr. Taradash, would you please give us your background for the record?

Mr. TARADASH. Yes; I practiced law in Window Rock, Arizona, in the Navajo Nation in DNA—that's a legal services program—from 1970 to 1976.

From 1976 through the better part of 1978 I was the Deputy Director of Economic Development for the Navajo Tribe, which included all the minerals of the Tribe.

From 1978 to 1983 I was the Director of Litigation at DNA responsible for all litigation for the largest Indian legal services program in the country.

Since 1983 I have been in private practice in Albuquerque, New Mexico, with my current firm, where I am a partner.

Ms. SOLLER. And in practice you specialize in Indian law and in natural resource law; is that right?

Mr. TARADASH. Yes, that's correct.

Ms. SOLLER. And, Mr. Chavez, can you give us your background please?

Mr. CHAVEZ. I am presently presiding over the Shi Shii Keyah Association, and also presiding over the Navajo Tribal Chapter near Bloomfield, which is northwest New Mexico.

Ms. SOLLER. And you also have personal experience in oil and gas work; is that right?

Mr. CHAVEZ. That's correct.

Ms. SOLLER. And what is that experience from?

Mr. CHAVEZ. I have been employed with a gas company in northwest New Mexico for the last 15 years.

Ms. SOLLER. And the work that you have done there is directly in the field; is that right?

Mr. CHAVEZ. That's right.

Ms. SOLLER. Now, you mentioned the Shi Shii Keyah Association. What is that group?

Mr. CHAVEZ. It is a group of Navajo allottees which have taken upon themselves to make an association and to go out and hire a private attorney, Alan Taradash, to work on some concerns that they had in about 1984.

Ms. SOLLER. And, Mr. Taradash, what concerns were you and your firm specifically hired to do on behalf of the allottees?

Mr. TARADASH. In 1984 the board of directors of the Shi Shii Keyah Association came to Albuquerque. In fact, we asked them that exact question: just what is it you want us to do? They listed, in order of priority, the problem of getting timely payments. Often royalty payments were anywhere from six months to more than a year late. They were provided absolutely no information with regard to the payment, so when they did ultimately get paid they had no idea as to why they were getting paid the amounts that they were receiving. They felt that, inasmuch as the payments were so late, that they at least ought to be getting some interest, and they weren't getting any interest on their money.

They had many other concerns that dealt with leaking wells, gas which continues to permeate homes making them uninhabitable, but those were their major four or five concerns.

Ms. SOLLER. And what did you do based on their complaints?

Mr. TARADASH. Made a demand upon the Secretary of the Interior. After two months of actual investigation to find out whether what we were being told was reasonably accurate, we made a demand upon the Secretary of the Interior to comply with the provisions of the Federal Oil and Gas Management Act of 1982.

We received, in about 40 or so days, from the designated hitter for the Secretary, a response basically saying that in their view, as they construed the act, they were in compliance, and they declined to do what we requested.

So at the end of October of 1984 we filed a lawsuit against the Secretary of the Interior to compel him to comply with the law.

Ms. SOLLER. Was the Navajo Tribe involved in this lawsuit in any way?

Mr. TARADASH. No; we sought the assistance of the Tribe as a party and they declined for a host of reasons that were never truly articulated.

They have supported the work of the Association through a modest financial contribution. But for that I'm not sure we could have continued over the last five years.

Ms. SOLLER. During the course of the lawsuit, did it progress smoothly so that you could seek the goals that you had set out to achieve?

Mr. TARADASH. Quite the contrary. What we asked for initially, even prior to filing the lawsuit, was simply a plan that had enough detail in it so that we could feel confident that if the Secretary, indeed, implemented the plan to be agreed upon, that he would be in compliance with the law.

Rather than dealing with that suggestion, which, again, we articulated after filing the suit, it was just one excuse and one reason for delay after another that went before the court, even to the point that the Secretary was in default in failing to file answers, repeated instances of the attorneys for the United States entering into stipulations and then breaking them quicker than the ink was dry on the paper, routine instances of just flat out lying to me and to the court.

And so for the last four and a half years of litigation it has been anything but smooth for no particularly good reason.

Ms. SOLLER. Now, litigation can become acrimonious, or at least adversarial, all the time. Did the fact that this litigation with these kinds of problems say anything about the way the government was responding to your concern?

Mr. TARADASH. Sure. It is worth noting that the attorneys representing the United States in the context of our litigation were principally lawyers within the Department of the Interior sitting over as the legal counsel for the Bureau of Indian Affairs, among others, but also the Minerals Management Service and the BLM.

Rather than any concept that they had a duty to look at the question of whether or not their client, the Secretary, was violating his trust responsibility to the individual allottees in this case, it was just the opposite. They took the view that they were lawyers defending their client, and as long as they had any position, no matter how sophomoric it might otherwise be, that they ought to assist in the effort to allow the Minerals Management Service principally to continue on as they had chosen unilaterally to do, notwithstanding repeated criticism by Mr. Shriver in December of 1984 in his report to the Secretary as the consultant directly to the Secretary of the Interior, and numerous critical reports from the General Accounting Office.

So the entire effort, from my perspective, was one of assisting the governmental agencies in allowing them to continue to act in violation of the law, and absolutely no concern whatsoever for the allottees for whom the Federal Government is supposed to have been the trustee.

Ms. SOLLER. Did you ever reach a resolution of this lawsuit?

Mr. TARADASH. A consent decree was finally reached and filed with the court on March 17 of this year.

Ms. SOLLER. How long had it taken from when you first began negotiations or contact with the government about this until it was resolved by the consent decree?

Mr. TARADASH. From September of 1984 to March 17 of 1989. But when you say "resolved," that is on paper. I have absolutely—well, two days ago, for example, one of the provisions of this consent decree which required implementation of the system to account for interest which, in the real world, has been done for the better part of a quarter of a century—

Ms. SOLLER. This is interest on——

Mr. TARADASH. On royalty payments which were late in being paid by the government to the allottees or by companies to the government for the allottees. There was supposed to have been an implementation of this system, the implementation date of which has slipped, from the beginning of negotiation, three times now, and I was advised two days ago that, as written in the consent decree, it is going to slip further because the government has now decided that they are going to implement a daily computation of interest system.

Ms. SOLLER. In reaching this consent decree did it satisfy all of your goals when you set out to litigate this action?

Mr. TARADASH. Absolutely not. You must understand that my firm is a small firm, and we've got to pay the rent like everybody else. This case is one which we're handling where we're not getting paid. The people we represent are extremely poor, and we've had to carry this case and borrow the money from the bank in order to finance the case. There is only so much that we can do, for financial reasons.

There is a lot that I would have liked to have done to ensure a proper production accounting system to ensure that the interest system is properly implemented. We may still get to do that in the context of going back to the court to seek compliance with the consent decree when we find out that the government is not in compliance. But because of the financial constraints that I just mentioned, it has been impossible to handle the case in the fashion in which I would have liked to.

Ms. SOLLER. Now, you mentioned that one of the original reasons for filing this suit was because there had been no accountability, or no explanation to the individuals who were entitled to these payments what they were getting or what they weren't getting; is that right?

Mr. TARADASH. Yes. That's correct.

Ms. SOLLER. Mr. Chavez, what was the feeling among the Navajo allottees about what they were experiencing when this suit was filed?

Mr. CHAVEZ. At the time that this suit was filed there were feelings of hopelessness of this whole situation because they have repeatedly, over and over, as individuals, gone to these agency offices and get the run around, which means some of these people travelled up to about 200 miles round trip just to get real rude treatment and then walk away. Because of that, I think the frustration presiding—when we run a chapter committee meeting, you really cannot write out an agenda because a lot of different people come to these meetings with a lot of different problems, and this was one of them that was being repeated over and over.

I think it is good that a group of these people finally got fed up with the whole situation and hired a private attorney to do some work for them.

Ms. SOLLER. Has the attitude of the BIA or of the government changed since the suit was filed?

Mr. CHAVEZ. I would say no right now. What Alan was saying is that we reached a consent decree, but the thing is that basically we don't look for a mountain to move on the first day because those kinds of treatment still exist, but at least now we have that consent decree that we can fall back on. The bigger problem still exists.

Ms. SOLLER. Mr. Taradash, do you have any feelings about whether or not the litigation or the consent decree or any of your actions has really had an impact on the day-to-day dealings or attitudes that the BIA in this area has in dealing with the allottees?

Mr. TARADASH. Marginally, at best.

Ms. SOLLER. Are there still problems?

Mr. TARADASH. Yes. There are many problems that are fundamental and serious. If I can take a moment to explain why it is that I think that no matter about the consent decree these problems will remain—and it has been reflected in the testimony that I have listened to in this room for the last day and a half.

We are fast approaching the end of the 20th century. The Bureau of Indian Affairs and the Minerals Management Service, to a certain extent, continue to insist that individual allottees and Tribes are not entitled to the same kind of level of integrity and financial responsibility that any person that deposits their money in a bank anywhere in this country is entitled to.

The systems that are in use—the method and manner of treatment of allottees in their dealings with the Bureau of Indian Affairs is something out of the last century, and there is a reason for that.

I have heard questioning about whether or not the bells and whistles work better at MMS or at the BIA. Those are the wrong questions, in my judgment. As therapeutic as it might be to make the horse go up on the merry-go-round better, it is not going to get us anywhere.

The system that we have on the Navajo Reservation through which royalty payments go was designed at the time in 1868 to ensure that the cavalry could control the people. There has been no fundamental change in the lack of accountability and insulation from accountability that that system produces.

I have represented children who have been sexually abused in boarding schools, I have represented families that have had members die because of criminal neglect at the Indian Health Service, and that is no different. The reason is no different from the failings here, and they go directly to the insulation from accountability.

If some little old white lady in Scottsdale, for example, goes to the bank where she has been told she has $3,000, and she is now told that she only has $100 left, and she asks why, if a clerk were to give to her an adding machine tape that the clerk punches out which shows the subtraction, that woman would not sit still for that. She would run and talk to the president or vice president of the bank.

Ms. SOLLER. Has that example that you just mentioned happened——

Mr. TARADASH. Absolutely.

Ms. SOLLER. —in the case of an Indian that you know?

Mr. TARADASH. Absolutely. Thompson Plotera, who happens to be blind, who has a wife that is blind, who is trying to put his kids through school, had exactly that happen to him, and that's what he got from the Bureau of Indian Affairs. For Mr. Plotera to impact the BIA and the Minerals Management Service we only have two courses of resolution: either we go to a federal judge and ask him to force the Secretary to do what any common bank clerk would do; or we have to see the creation of a special committee of the United States Senate to do that which any other citizen can reasonably expect in this 20th century.

Now, unless that fundamental problem of the design of the system of control of Indian affairs is dealt with, then what you're going to get is essentially a system that may work better for a while. It may even be more than a marginal improvement. But it is never going to work in the sense of empowering the people that it is intended to serve to have some direct ability to affect those who are supposed to be working for them.

There is not one single person in the last four and a half years of litigation that we have dealt with at the BIA or the MMS, no matter how badly they have lied to a federal judge or have broken stipulations that they have entered into which have been filed in the court, that has gone one day without getting paid.

Now, if you want the MMS and the BIA to work properly, you ought to say, "Fine. You get these payments in on time and you provide the explanations of payments and the impositions of penalties, and then you'll get paid."

If you are willing to do that, then you may see a change—but not until.

If you empowered the people that are served by emulating the corporate form, for example, of boards of directors composed of the people who have a vested interest in the venture, then maybe we can get better accountability at the local area level. Those are not things that are impossible. Those are things that are legislatively not difficult to design.

So while we are very grateful for the work of the committee—and it has been extremely helpful for us—in listening to the questions, there is a continued inquiry of witnesses that asks the wrong question: is MMS better compared to the BIA or the BLM? The last witness said it was far and away better. But it is sort of a "So what?"

Ms. SOLLER. So what would be some suggestions that you would have to empower the people better and to make the system more accountable?

Mr. TARADASH. The situation is going to be markedly different for different parts of the country because all Indian tribes are not the same, all Indian allottees are not similarly situated. Therefore, you have to build in, I think, enough options so that you have practical solutions that can come about in legislation.

Since the middle to late 1960s, when the Federal Government finally changed from a system of trying to terminate Tribes to self-

determination, the policy ostensibly has been to empower tribes to run their own affairs. Allottees have fallen in the huge cracks, so to speak. There is no reason why that has to continue.

There is no reason why, for example, there has to be a singular approach to handling minerals royalties that is run through Lakewood, Colorado. When we have asked, in the context of our litigation—we want to have a notice that is received by an allottee, no matter what else is received, when the producer is not making a payment and hence there would be no money coming in. That's when, more than any other time, we need to have a notice that says, "You're not going to get paid this month." Because the consequences of no notice are that a person literally drives or hitchhikes several hundred miles to find out that there is nothing there.

The only information they can get is that the clerical person at the BIA, after a long wait, ordinarily will look in what they call "The Book," which is a computer printout, and will simply say, "There is nothing here for you."

The question is asked, "Well, when will there be something?" The answer, "I don't know. You can come back tomorrow and check again."

Well, for most of the Navajo allottees, they live on very little money each month, and that money is critical. If they're not going to get it, then that's when they need to know they're not going to get it.

So we requested simply that zero sales reporting flow through to the payee, in effect. The response we got was, "We can't change the whole system. We have to account for billions of dollars that come from Alaska and Okefenokee and everywhere in between, and what you're asking us to do is modify the whole system for you." That sort of thing happens again and again.

It is very plain that when we request something that, in the real world, would simply be done, the response was, "Well, we can't do it because of the institutional constraints. We have an institutional inability to do that which is required."

In other words, we designed a system without regard to the trust responsibility as it relates to allottees—or Tribes, for that matter—that are specifically mentioned in the statute.

I deposed Randall Drake up in Lakewood and asked him that very question.

Ms. SOLLER. And who is Mr. Drake?

Mr. TARADASH. He is the head person in charge of Indian royalties—at least he was at the time I deposed him.

I asked if he consulted with anyone at the BIA? "No, we did not." I asked the BIA area director at that time, Wilson Barber, in his deposition, "Did anyone at the Minerals Management Service consult with you when they designed the system?" "No, they did not."

The response that we then get when we ask for rational things that any sane person in the real world would want to know is, "We've already designed this system, and no matter how many critical reports there are, we spent a bunch of money and designed the system, and we're not going to change the whole system because it is not economically feasible to do."

You do a cost/benefit analysis at that point in time after making those unilateral decisions, wholly ignoring the trust responsibility, and then you set up, as the test to determine whether or not you can make a modification, whether or not it is in a cost/benefit analysis cost effective.

Well, Indian allottees are always going to be at the bottom of the heap in terms of their power and in terms of their dollars in the system.

Of course, we're never going to get that which the trust responsibility requires. That is a given. That's where we started. It has been very difficult to get movement in that respect. We have gotten some, but the deck has really been stacked against us.

I have gotten off on a tangent to your question, but there is a need to understand the dynamic when you ask some of these questions about whether or not there have been difficulties in the litigation, about whether or not this system works better than the other. You have to go back, I think, to look at the fundamental design defects and the fundamental willful ignorance of the federal trust responsibility.

We were told time and time again, for example, in the context of this litigation, that that's not something the MMS does. That's the BIA's job.

Well, that's not what Congress said when they wrote the statute. When they wrote FOGRMA they didn't put in the word "MMS" or "BIA". They said "Secretary of the Interior." The Secretary has a different duty.

I watched on C-Span and I saw Mr. Hodel and various panels just about crying over what he could do to assist the oil and gas industry. That was his perception of his duty—to assist that industry.

When we asked just for the most modest level of enforcement of the trust responsibility, we are told no, and the reason has to do with a willful refusal to even acknowledge the existence of the trust responsibility.

Ms. SOLLER. Mr. Chavez?

Mr. CHAVEZ. This morning I heard a testimony by Tom Shipps for the Southern Ute. I don't mean to contradict some of his statements, but I think there was a question asked about the impact of the 1984 oil crisis. Since they were on top of their accounting control, I think he said that it didn't really have an impact on their Tribe.

But the thing is, you have to understand that with our Navajo allottees—I think Mr. Norman couldn't have said it any better. Allottees are on their own. We are on our own. We are basically at the mercy of the Bureau of Indian Affairs as far as any accountability goes.

You have to understand that, at that time, when the oil prices dropped, it had a totally devastating affect on an average allottee because, at the time, they were only receiving a fraction of their money anyway, and a lot of their monies were being lost or not accounted for in the system. So the need of accurate accountability is needed more than ever.

I think a lot of these people, whenever they receive checks for something like one cent or two cents or five cents in the mail, they almost get the feeling of being laughed at. Some of those people

that at least had some pride in themselves are forced to go apply for food stamps and welfare, and then they get the run-around saying that they're on the list of people that receive royalties, and they get the run-around, and they basically have to starve to death before they even get some assistance.

Ms. SOLLER. One of the things we have heard is that the three departments or agencies—BIA, BLM, and MMS—are now talking better and that things are running more smoothly. Are you finding out there in the real world that, in fact, the allottees are now better able to get answers for their questions, as in the example Mr. Taradash mentioned of somebody who doesn't get a check and asks where it is?

Mr. CHAVEZ. I would say I have witnessed no improvement whatsoever. It might look good on reports coming up here, but back there in the real world it has no change whatsoever.

Ms. SOLLER. Mr. Taradash, have you had a recent example of a situation in which just such a case occurred?

Mr. TARADASH. Sure. And not a singular recent example, either.

One woman, Esther Valdez, had not been paid royalties for over three months. Her vehicle was repossessed and she was told that it was going to be sold. You must remember that where she lives there are no paved roads, and she uses her vehicle to haul much of what she subsists on—she and her family.

I called and talked with the acting person at the BIA in Window Rock to find out what happened to her royalties. I called Ken Moyers, the chief of royalty compliance up in Lakewood. A day went by while they were ostensibly getting information. I received a telephone call back.

I ultimately spoke to the person who the report would indicate to you is knowledgeable about oil and gas from Window Rock, and I'm told that they have just dispatched this particular employee of the BIA to go to Shiprock to negotiate with the Shiprock office. Negotiate for what? I have absolutely no idea.

It is that kind of non-real world that you cannot possibly understand until you have to deal with it on a day-to-day basis.

All I want to know is where this lady's money is. The fact, as it turns out later, is that the producer was stockpiling. This has occurred time and time again. And, of course, no one at the BIA knows that. No one at MMS knows that because they don't look for that sort of thing.

We were ultimately able to get her check for her, and she was able to get her vehicle back. But we have not always been so lucky. A number of people have lost trucks.

Kids have gone to school with no clothes, weddings have been canceled because there is no money when there was production on their lands.

When I have mentioned that to the attorneys for the United States, the shameless response I get is, "These people will get their money eventually, and as long as they're going to get all that is coming to them, why are you so upset that they're not getting it now?"

That's what you all in the Congress are paying for in the way of fulfillment of the trust responsibility. Unless you deal with it on a day-to-day basis, you cannot begin to know how frustrating it is

and how just absolutely shameless it is. But that's the way that the Federal Government fulfills its trust responsibility to Indian people.

Ms. SOLLER. Mr. Chavez, is the answer, then, that since tribes, as we heard this morning, seem to be doing at least a better job than MMS or the Federal Government is at handling their own resources, should Congress allow the Navajo Tribe to take over the handling of the allottees' royalties and resources?

Mr. CHAVEZ. I'm not sure. I don't want to speak for the Navajo Tribe because we are basically in the checkerboard area, but I would like to speak for the Association, if I can.

In listening to some of the testimony, you keep throwing money at a system that does not work, and keep shoveling money after money. The things is, I think the Southern Ute is a good example of a good system—what they developed. If Congress could help us with funding some of these smaller projects and how we could best use those systems within our area, I think that would be more effective. I think more Navajos could get their money a lot quicker and keep track of it.

Ms. SOLLER. Mr. Taradash, do you think it could be funded through the tribe, or should there be some other way set up to do it?

Mr. TARADASH. It is conceivable that it could be very cost effective—"it" being true minerals management for allottees—including more than just trying to figure out who is supposed to get how much money, but, rather, resource management.

It could, indeed, be done in conjunction with the tribe. The system that the Navajo Tribe has set up is, in some ways, very good. But they are very underfunded, and they cannot undertake additional work without assistance.

They have a great deal of expertise, however, like the Southern Ute Tribe and some other tribes.

There are many of the responsibilities that the Federal Government, on paper, is supposed to do that it is not doing and everyone knows that it is not doing, that could, must more easily be done by people in the community.

If you were to look at site security, for example, where the BLM, a few years back, had 18 positions, only 12 of which were actually filled, to look after 10,000 wells in the San Juan Basin, they don't get up to Montezuma Creek by Mary Johnson's house. But Mary Johnson is there every day, and she knows when the wind shifts and drives the fumes from the gas well through her house that she has to leave because everybody gets sick.

If there were people that were responsive to the community because they were from the community and they were funded—and it doesn't have to be on the scale of the Minerals Management Service—they could do a much, much better job, and they are very capable of doing that.

Ms. SOLLER. And right now is it correct that the law prevents the allottees from doing these things for themselves the way tribes may be able to do it under certain agreements?

Mr. TARADASH. That's correct.

Ms. SOLLER. Mr. Chairman, I have no further questions at this time.

Senator DECONCINI. Thank you.

Mr. Taradash, let me ask you this question: you have raised a question that has been troubling for a long time, and this committee has spent some time addressing the "trust responsibility" or lack thereof, as I like to put it. I agree with you that Secretaries, on a nonpartisan basis, just do not follow what I believe is very clearly at least the intent, if not the exact directive of the Congress, to deal with Indian Affairs as a priority.

Should we consider a separate trust office to look after the trust responsibility that the government has with the Native Americans other than the Secretary of the Interior and the Solicitor? Is there a conflict? It seems to me clearly there is a conflict, but I'm looking for your opinion.

Mr. TARADASH. Absolutely, Senator DeConcini. And to understand how that conflict actually plays out in the real world, let me, if I may, depart a little bit from minerals to tell you of a sexual abuse case that I handled at a reservation boarding school.

When I presented to the then field solicitor in Window Rock uncontroverted evidence of the fact that sexual abuse had taken place, the conflict in testimony between the principal and the vice principal of the boarding school, on the one hand, and the guidance counsellor who had been abusing these children for many years, on the other, when I presented the tapes of those interviews, when I presented the polygraph exam that the person had failed, when the psychiatrist who I had retained from Stanford had come to testify and explain why it was that these children were telling the truth, the concern of the field solicitor was for the civil service rights of this person that had done these things.

His solution that he proposed before the Advisory Committee of the Navajo Tribal Council at a hearing to exclude this person from the reservation was, "Don't worry. We're going to transfer this person to a school in Alaska with Native children there."

The conflict plays out in the real world in very cruel ways, and I think your suggestion, if it is one, is one that is excellent if we get a cabinet-level secretary who is responsible for implementing the trust responsibility of Indian affairs.

Senator DECONCINI. If not cabinet level, you're talking about separate from the solicitor and the Secretary of Interior? Somebody that wouldn't be, in your judgment, under them——

Mr. TARADASH. Absolutely, Senator.

Senator DECONCINI [continuing]. So they couldn't be told what to do, because there seems to be a conflict.

During our first round of hearings we had some tragic examples of what you have just given us on child abuse where it appeared that the solicitor and the BIA, on behalf of the Department of Interior, were not looking after the trust responsibility they have for Indian children. Clearly they were not doing it. Maybe it was incompetence, but nobody seemed to give a damn about what was happening there, and it is a problem that transcends over to allottees here.

And then you get to the tragic stories that you have laid out for us today where this is all they have. And if it is decreased because truly of market values and the things that are legitimate, so be it. There is nobody saying that these royalties are an entitlement. But

to be diminished because of bad management, neglect, unresponsiveness, or by "legal theft," as explained earlier today which is falsifying records or putting into a system data that falsifies the records, is just unconscionable.

I thank you both for your testimony.

Mr. CHAVEZ. Senator, could I make one last statement?

Senator DECONCINI. You certainly can.

Mr. CHAVEZ. I think just the lack of response to the people out there by these BIA employees—myself, being an elected official of my community, I have to deal with education, health, and all different kinds of fields.

I think you are going to have hearings starting Monday on Indian Health Service. I think this is another branch of the government that really does not have—we do not have any control whatsoever as far as us at either end having any control over these responses, and I think this is the same thing we're talking about in the testimony that has been here over the last two days. I just wanted to throw that in.

Senator DECONCINI. Thank you. I think we're going to find that Monday.

Thank you gentlemen very much.

Mr. TARADASH. Thank you, Senator.

Mr. CHAVEZ. Thank you, sir.

Senator DECONCINI. Our last witness is Mr. Eddie Jacobs, President, Oklahoma Indian Minerals Owners' Association and member of the Creek Nation Minerals Task Force.

[Witness sworn.]

Senator DECONCINI. Ms. Soller.

Ms. SOLLER. Thank you.

STATEMENT OF EDDIE JACOBS, PRESIDENT, OKLAHOMA INDIAN MINERALS OWNERS' ASSOCIATION; MEMBER, CREEK NATION MINERAL TASK FORCE

Ms. SOLLER. Mr. Jacobs, where do you live currently?

Mr. JACOBS. I live in Oklahoma City presently.

Ms. SOLLER. And are you a member of any Tribal group?

Mr. JACOBS. Yes. I am a member of the Muscogee Creek Tribe, which is a member of the Five Civilized Tribes which we heard reference to before.

Ms. SOLLER. And do you have restricted land in Oklahoma?

Mr. JACOBS. Yes, I do. I have four active leases—two in Creek County and two in MacIntosh County.

Ms. SOLLER. Are you a member of any group or organization of mineral owners?

Mr. JACOBS. Yes. I was recently appointed to the Creek Nation Task Force that is looking into problems that our Creek allottees are experiencing, and I am also an elected board member of the Oklahoma Mineral Owners' Association, which is made up of a group of individuals that have mineral holdings there in Oklahoma.

Ms. SOLLER. And is this Oklahoma Mineral Owners' Association a funded group by anyone?

Mr. JACOBS. No. We receive no funding. That's the reason I'm sitting here by myself. We don't have a lawyer or accountant or anyone to look out for our interests, although some of our individuals do get private attorneys on an individual basis.

Ms. SOLLER. Is it supported by any tribal group?

Mr. JACOBS. No. The Oklahoma Mineral Owners' Association is not.

Ms. SOLLER. And what is the purpose of this group?

Mr. JACOBS. To look into problems that our mineral owners are experiencing.

Ms. SOLLER. And, based on your participation in this group and in the Creek Minerals Task Force, I understand you have been quite outspoken in allottee issues; is that right?

Mr. JACOBS. Yes. I heard from the testimony that was given earlier by your experts many of the problems that we have been bringing up since early 1983 when the change-over from manual to computer was taking place.

Ms. SOLLER. And based on your active participation in these groups, were you selected to be a member of the Royalty Management Advisory Committee for MMS?

Mr. JACOBS. Yes. I received appointment last year from Secretary Hodel.

Ms. SOLLER. And what is the Royalty Management Advisory Committee?

Mr. JACOBS. It is a group made up of members from industry, tribes, and the Indian representatives.

Ms. SOLLER. How many people are on this? This is called RMAC; is that right?

Mr. JACOBS. Right.

Ms. SOLLER. And how many people are on RMAC?

Mr. JACOBS. Presently there are 26. Originally there were more.

Ms. SOLLER. And how many of those are industry people?

Mr. JACOBS. Thirteen are industry, six are state representatives, and we have seven Indian representatives.

Ms. SOLLER. And of those seven Indian representatives, how many are representatives of allottees?

Mr. JACOBS. I am the only representative that represents the allottees.

Ms. SOLLER. Do you know whether or not MMS consults with any other group of Indians other than RMAC on a regular basis?

Mr. JACOBS. Presently I don't know of any.

Ms. SOLLER. Now, you indicated that you have a lot of contact with allottees in Oklahoma, but what about allottees or individual owners of restricted land in other states?

Mr. JACOBS. I don't have that much knowledge of the allottees in other states because we mostly concentrate on our problems there in Oklahoma, and Oklahoma is rather unique in the fact that the majority of the lands in Oklahoma were allotted out, and our tribes have very few land holdings.

Ms. SOLLER. Do you feel that there is any representation for allottees of other groups that have differing interests or concerns other than Oklahoma in front of the Minerals Management Service?

Mr. JACOBS. Would you restate that?

Ms. SOLLER. Does Minerals Management Service consult, to your knowledge, with any allottees outside of Oklahoma? Or are you expected to represent all of them?

Mr. JACOBS. Evidently on RMAC I'm expected to represent all of them.

Ms. SOLLER. Do you think you can do that?

Mr. JACOBS. If I'm not aware of the problems they're experiencing, I would say I can't.

Ms. SOLLER. Do you know whether or not MMS has conducted any kind of outreach to individual Indians or to individual allottee groups, either through mailings or meetings or anything, to try to get input into how they were conducting the system?

Mr. JACOBS. I have heard of a survey, but none of our membership received any letter, so I personally couldn't say that I have any knowledge of any.

Ms. SOLLER. Have you been consulted at all as to how the MMS system is actually working from an end-user from your point of view?

Mr. JACOBS. As a member of RMAC, they did send out a survey that wanted opinions on different questions that they had posed. So that's the gist of it, I guess.

Ms. SOLLER. And that was just to you as one member?

Mr. JACOBS. Just to me as one member.

Ms. SOLLER. Have you ever been consulted or asked whether or not the payment schedule of royalties is acceptable or effective?

Mr. JACOBS. Yes.

Ms. SOLLER. And have you told them what you think of this?

Mr. JACOBS. Yes. I have told them that I feel that it is incomplete. The information that we receive is only the seller information—production.

Ms. SOLLER. And have they changed it in any way?

Mr. JACOBS. They have made some minor changes, but the changes that they have made are still insufficient. We still can't understand the amounts that are produced. The only thing the statement shows is the amount that is produced and sold for that month. It doesn't show the total lease production, which we need to be assured that we're getting our fair share.

Ms. SOLLER. Have you tried to communicate your concerns to MMS?

Mr. JACOBS. Yes.

Ms. SOLLER. And have you seen that this has had any effect on their policies or procedures?

Mr. JACOBS. Only minor changes.

Ms. SOLLER. Has there been any outreach that you have seen by the Bureau of Indian Affairs in mineral management—contacting you or any other individual allottees or any allottee organization to find out whether or not their handling of minerals and royalties was effective?

Mr. JACOBS. No.

Ms. SOLLER. Are you aware that there is a royalty statement project that the Bureau of Indian Affairs is supposedly conducting to try to redo the explanation of payment form?

Mr. JACOBS. No, I'm not aware of it.

Ms. SOLLER. Have you been contacted in any way about any proposed changes or suggestions you might have?

Mr. JACOBS. No, I haven't.

Ms. SOLLER. Has there been any outreach at all by the Bureau of Indian Affairs, either at the agency level or at the area office or at a national level, that you are aware of, to allottees in Oklahoma to find out whether or not there is an effective day-to-day operation of minerals and royalty programs?

Mr. JACOBS. No, I'm not aware of any.

Ms. SOLLER. Has BLM ever conducted one?

Mr. JACOBS. No.

Ms. SOLLER. If there were such outreach programs by any of these agencies, would you have things to tell them?

Mr. JACOBS. Yes, I would.

Ms. SOLLER. What do you think is needed out there by any of these agencies or by a restructuring of the system?

Mr. JACOBS. Well, if BIA was doing their job, they should be sitting in this position instead of me right now, for one thing. I wouldn't be sitting here if they were doing their job.

And, as we heard earlier, if BLM was doing their job we wouldn't be getting ripped off by the oil companies.

Ms. SOLLER. What do you mean they should be sitting there instead of you?

Mr. JACOBS. Well, as I have heard earlier, they talk about the trust status that exists, so if they are going to maintain this trust, shouldn't there be a representative here?

Mr. BALLEN. You were here earlier in the week, Mr. Jacobs, and heard the testimony about BLM——

Mr. JACOBS. Yes.

Mr. BALLEN [continuing]. And what was happening out there in Oklahoma?

Mr. JACOBS. Yes.

Mr. BALLEN. How does that make you feel?

Mr. JACOBS. It just confirms what we haven't been able to confirm on paper ourselves.

Mr. BALLEN. You thought this kind of activity was going on out there?

Mr. JACOBS. Yes. I still suspect that there is a lot of it going on.

Ms. SOLLER. And had you reported——

Mr. BALLEN. And you saw the attitude of the BLM officials here?

Mr. JACOBS. Yes. I have had contact with Mr. Sims and Mr. Goodman, both.

Senator DECONCINI. Do you know where the FBI number is? [Laughter.]

Mr. JACOBS. I believe I could locate it if I wanted it.

Ms. SOLLER. What is your experience with the day-to-day attitude of the Bureau of Indian Affairs officials that you have come in contact with, or other allottees that you know have come in contact with?

Mr. JACOBS. That's where I believe a lot of the allottees' problems start—at the BIA—because we have a certain chain of command that the individuals have to go through, and this is where we begin, and the BIA hasn't been responsive at all to any of our requests for information or anything.

Ms. SOLLER. You heard Mr. Taradash and Mr. Chavez speak about what it is like in the Navajo area and in New Mexico. Are things any different in Oklahoma, or are they the same?

Mr. JACOBS. I guess they would be the same all over. That's what I have knowledge of.

Ms. SOLLER. Now, I asked both of the earlier gentlemen whether or not the Tribes should just take over the handling of allottee oil and gas issues and their problems, and they indicated it might vary from place to place. What is your feeling about that as far as Oklahoma is concerned?

Mr. JACOBS. I know in Oklahoma, like I stated earlier, our Tribes have very little land resources, so I don't think it would work in Oklahoma, because the majority of our lands have been allotted out, and I just don't see how our tribes could even justify requesting 202 contracts, because what tribal leases we do have, the amount of money is very minimal as far as other tribes across the nation.

Ms. SOLLER. Would you want to have the tribes handling your resource issues, or would you like to see some other system developed?

Mr. JACOBS. I would like to see another system developed—something independent of possibly MMS as far as auditing goes. MMS seems to be only collecting the monies that are turned in to them. They don't get the—I don't know whether this has been brought out, but they don't get the total lease information. All they receive is the Indian share of the information, as far as sales. As it is now, there is no way of checking to see whether those sales are matching up with the production.

Ms. SOLLER. Mr. Jacobs, from your contact with other allottees in Oklahoma, do you believe that they have a sense—and, if so, what sense do they have—of how the system is working for them now?

Mr. JACOBS. No.

Ms. SOLLER. Do you know how most of them feel?

Mr. JACOBS. They feel discouraged in that we can't get anything done, just like we heard Mr. Taradash and the other gentleman state earlier.

Ms. SOLLER. I have no further questions, Senator.

Senator DECONCINI. Senator McCain?

Senator MCCAIN. We know you came a long way to be here today, and we are appreciative of your testimony. Is there anything you'd like to add that you think this committee should know or hear?

Mr. JACOBS. There are a couple of things I'd like to add if we have the time.

Senator MCCAIN. Sure.

Mr. JACOBS. There is a tax situation that was brought out earlier that exists only in the State of Oklahoma where our royalty shares are assessed a gross production tax, which is by the State of Oklahoma. I have been asking for a number of years now for someone to give me an opinion as to why we were made the exception. As of this date I haven't received that opinion. I have even requested it of your solicitor's office.

Senator MCCAIN. Well, if you'll drop me a note, the committee will investigate that for you.

Mr. JACOBS. There is another problem that exists. In the delay of our payments, as was brought out earlier, some of the interest money historically—I'm not talking about this period from 1983 on—has gotten lost in the process. This money is being held in Albuquerque, I understand, at the Investment Center. I'm just wondering when this money will ever be released to its rightful owners.

Senator MCCAIN. We'd be glad to look into that, too. We'd appreciate it if you would send us that request in writing because we'll probably have to request information for you in writing. Okay?

Mr. JACOBS. Okay. I have made requests of different agencies numerous times in writing, and——

Senator MCCAIN. Make it of us.

Mr. JACOBS. I certainly will.

Senator MCCAIN. We'll see what we can do.

Mr. JACOBS. There are a number of other things that I have submitted in a written statement that you will probably want to read, as well. A number of them were covered by your expert witnesses, and I was glad to hear that they were brought out because these are problems that we have had knowledge of for a number of years, and we're pleased to see that we are finally getting some recognition from someone who hopefully can do something for us.

Senator MCCAIN. Well, I can assure you of the recognition. I can't absolutely assure you that we'll be able to do something significant. But I seriously hope you understand that we not only intend to recognize, but we intend to try and help to make sure that you and your Tribe receive your fair and equitable distribution of these monies.

Frankly, it is a disgrace, in my view, that this kind of thing has gone on for so long. I think that it has become apparent to me, anyway, that one of the reasons why this has gone on so long—and I'd be interested in your opinion—is that we're talking about a very complex set of circumstances here. Would you agree with that?

Mr. JACOBS. Yes. Like you say, this has been going on for quite a while—I would say since around the turn of the century, in fact. In Oklahoma, this is one of the reasons I feel that our Oklahoma Indians were assessed a tax early, because we had production as early as 1913 and 1914 there in Oklahoma—around Statehood time. So we need to put an end to this.

Senator MCCAIN. Thank you, again, for coming.

Mr. JACOBS. Thank you.

Senator DECONCINI. And I thank all the witnesses.

This committee will stand adjourned until 9:30 tomorrow morning.

[Whereupon, at 4:40 p.m., the committee was recessed, to reconvene at 9:30 a.m. on Friday, May 12, 1989.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

TESTIMONY OF B. KEVIN GOVER,
GOVER, STETSON, WILLIAMS, & WEST, P.C., ALBUQUERQUE, NEW MEXICO,
BEFORE THE SELECT COMMITTEE ON INDIAN AFFAIRS,
SPECIAL COMMITTEE ON INVESTIGATIONS
UNITED STATES SENATE
MAY 11, 1989

o

Mr. Chairman, members of the Committee, I appreciate this opportunity to present testimony today on the important issue of dual taxation of mineral production on Indian lands. As you know, the Supreme Court has issued its decision in the case of Cotton Petroleum v. New Mexico. With that decision, the Court has made clear that, under existing law, states are free to tax reservation oil and gas production at will. While the effects of the decision are yet to be felt, it requires little imagination to realize that oil producers will be reluctant to do business in areas where the tax burden is higher than in other areas of the country.

Before turning to a particular discussion of Cotton and its ramifications, let me first review the law as it stood before Cotton. This review may be helpful in understanding the changes wrought by Cotton and in determining what steps are available to the tribes, the states, and the federal government in ensuring that Indian reservations are not disadvantaged in oil and gas development activities.

Tribal and state jurisdiction to tax in Indian country has been the subject of a flurry of United States Supreme Court decisions over the last sixteen years, and a confusing and, in my view, one-sided jurisprudence has emerged. Prior to 1965, the Supreme Court had addressed the legality of combined tribal and state taxing jurisdiction only on two other occasions. Beginning in 1965, however, the Supreme Court began developing a framework for the resolution of issues involving taxation of persons, property, and activities in Indian country. In just the last sixteen years, the Court has issued twelve decisions addressing tribal and state taxes imposed in Indian country. Eight cases were decided from 1980 to 1985.

As to tribal taxation, the Court has held a tribe may tax whenever it has a significant interest at stake. Such an interest is present where the taxpayers are Indians, or where non-Indians enter Indian-owned lands. Significant tribal interests also are at stake where non-Indians engage in commercial dealings with tribal members on reservations, or create or threaten impacts upon the tribe's political or economic integrity, or health and welfare. Early indications are that courts are not reluctant to uphold broad tribal jurisdiction to tax both Indians and non-Indians. E.g. Burlington Northern Railroad v. Blackfeet Tribe, No. CV-87-120-GF, slip op. (D. Mont. 1988) (upholding the Blackfeet Tribe's Possessory Interest Tax as applied to Burlington Northern Railroad property located on a right-of-way through the Blackfeet Reservation).

With respect to state taxation, the Court has upheld certain taxes upon non-Indians, but has prohibited taxation of Indians absent explicit congressional consent. The precise scope of state power to tax in Indian country remains uncertain. In part, this uncertainty exists because the Court is deciding state jurisdiction questions on a case-by-case basis by balancing governmental interests. While this approach gives the courts flexibility to deal with diverse circumstances in Indian country, uncertainty regarding tax obligations continues to burden investment decisions. Moreover, State taxation issues increasingly will involve circumstances where Indian tribes tax the same activities, as in Cotton. Thus, future challenges to state power to tax likely will be litigated in the context of unequally high tax burdens in Indian country due to tribal and state taxes upon the same activity. The scope of state power to tax turns on several inquiries, including, most importantly, an identification of the state interests that will be deemed to justify state taxation. The Court engages in a particularized inquiry to determine whether state taxes have been pre-empted under federal law in particular cases.

I. STATE TAXATION OF NON-INDIANS IN INDIAN COUNTRY

In contrast to state jurisdiction to tax Indians in Indian country, no per se rule prohibits state taxation of non-Indians in Indian country. State taxes, however, must overcome at least two barriers. First, the states may not tax activities that are federally pre-empted. Second, state taxation may not infringe upon tribal self-government. Federal pre-emption takes two forms. First, as was set forth in a 1965 decision by the Supreme Court, state taxes will be pre-empted if the federal government has so pervasively regulated the activity to be taxed that no room is left for state regulation. The other form of federal pre-emption is one which focuses on the federal statutes and their purposes. If a state tax conflicts with federal policies or purposes indicated in federal statutes, then federal pre-emption may lie.

A. Federal Pre-emption of State Taxation

In the early pre-emption cases, pervasive federal regulation was the focus of the Supreme Court's analysis. The Court also expansively read the federal statutes that gave rise to the federal pre-emption claim and liberally presumed the injury that would result to the tribe or other persons protected by the federal statutes. More recently, Chief Justice Rehnquist's view of the proper application of federal pre-emption principles has gained support. His view seems to be that the Court should very narrowly construe federal statutes that purportedly pre-empt state authority and should find clear, tangible injury resulting from the state tax. The Court increasingly is willing to find that state services to the taxpayer may justify even state taxation that conflicts with federal objectives.

Prior to Cotton, the law regarding state taxation of oil and gas production was the decision in Crow Tribe v. Montana, 819 F.2d 895 (9th Cir. 1987), sum. aff'd, 108 S.Ct. 685 (1988). In Crow Tribe, the State of Montana imposed a 30% tax on coal production from the so-called Crow

Reservation "ceded lands". In addition, a county had enacted and sought to apply its gross proceeds tax on the same production. The Court held that the state taxes were pre-empted by federal law and that they infringed unlawfully upon Crow tribal sovereignty.

The Court began its analysis by reviewing the pre-emption doctrine in Indian cases, noting that:

> The pre-emption analysis in Indian tribal cases differs from that used in other circumstances. ... Congress attaches great significance to the firm federal policy of promoting tribal self-sufficiency and economic development ... It intended that this policy be given "broad pre-emptive" effect. ... Moreover, "[n]o express congressional statement of pre-emptive intent is required; it is enough that the state law conflicts with the purpose or operation of the federal statute, regulation, or policy."

Id. at 898 (citations omitted).

The Court then turned to the 1938 Indian Mineral Leasing Act, noting:

> We have already indicated that the purpose of the 1938 Act was, inter alia, to revitalize tribal governments by giving them control over the leasing of their lands subject to the approval of the Secretary of the Interior, and to promote federal economic development. ... A major purpose of the 1938 Act is "to insure that Indians receive the greatest return for their property."

819 F.2d at 898 (citations omitted.) The court then concluded that, if the tribe were able to demonstrate that the state interfered with the policies underlying the 1938 Act, the taxes would be subject to pre-emption.

Montana argued that its taxes do not burden the Crow's economic interest because the Tribe itself was not paying the tax. The court rejected this argument:

> The state taxes increase the cost of production by the coal producers reducing in turn the royalty that can be paid to the Tribe. The taxes also force the coal producers to charge higher prices, reducing the demand for their Montana coal and resulting in fewer sales for the producers and fewer royalties to the Tribe.

Id. at 899.

In support of these conclusions, the court reviewed a study prepared by the Tribe's expert witness in economics. The Court found persuasive the conclusions reached in the expert's report, concluding that:

> The District Court did not find the impact of taxes to be negligible. As long as the taxes "interfere or [are] incompatible with federal and tribal interests reflected in federal law," they are deemed pre-empted "unless the state interests at stake are sufficient to justify the assertion of state authority."

Id. at 900 (citation omitted).

The court finally turned to its analysis of any state interests that purportedly justified the state and county taxes. In this regard, the court noted:

> We held that the pre-emption analysis requires the court to consider the state's legitimate interests. Ultimately, the question is one of reviewing the state, federal, and tribal interests involved and whether, in this context, the state action is contrary to federal actions. In Cabazon, the Supreme Court stated that "the federal tradition of Indian immunity from state taxation is very strong and ... the state interest in taxation is correspondingly weak. Accordingly, it is unnecessary to rebalance these interests in every case" ... The Supreme Court has increased the presumption against finding legitimate state interests. Hence, even if we agree with the District Court that Montana taxes support legitimate interests, the interests described in Crow I and argued by Montana may no longer be sufficient .... The same may be said here. Coal production is vital to the economic development of the Crow Tribe. Like the bingo games [in Cabazon], Crow's coal leases generate funds for essential tribal service and provide employment for Tribal members. ...
>
> Given the significance [of] these federal and tribal interests, Montana faces a heavy burden overcoming them with a showing of legitimate state interests. Even if Montana interests are sufficient and legitimate, there is substantial evidence that the coal taxes are not narrowly tailored to support them.

Id. at 901.

The court then reviewed the record to determine whether Montana's taxes were narrowly tailored to support compelling state interests. The state interests found in the record included additional costs associated with treating the environmental consequences of coal production, but the state did not provide specific figures to support these costs. With respect to services delivered to the ceded strip, the Tribe's expert witness had shown that other state, local, and excise taxes provided the state with ample revenues. The court also noted that Montana allocates a significant portion of the coal tax revenues collected to a permanent trust fund. Neither of the funds were dedicated to environmental or coal-related services. The court thus concluded that these facts "... indicate a distant, rather than carefully tailored, relationship between the severance tax revenues and the coal related services." Id. at 901.

The Court thus concluded that the Montana and county taxes are pre-empted:

> Montana's coal taxes are pre-empted by federal law and policies. They interfere with tribal economic development and autonomy. The state interests they promote may or may not be sufficiently legitimate to overcome these conflicts, but even if they are, the state taxes are not narrowly tailored in pursuit of these interests.

Id. at 903.

As noted above, the Ninth Circuit's decision was affirmed summarily by the Supreme Court. Thus, prior to Cotton, the law was that the 1938 Indian Mineral Leasing Act, under which most leases for reservation oil and gas production are made, pre-empted state taxation of production. The Ninth Circuit's painstaking analysis in Crow and the summary affirmance of that decision by the Supreme Court seemed to mean that reservation oil and gas production would be subject only to such taxation as the tribes chose to impose.

B. Infringement on Tribal Self-Government

In 1959, for the first time in decades, the United States Supreme Court addressed the Indian sovereignty doctrine. In Williams v. Lee, 358 U.S. 217 (1959), the Supreme Court held that the state court lacked jurisdiction to hear a dispute arising between an Indian and a non-Indian over a contract executed on the Navajo Reservation. The non-Indian had sued the Indian in state court for money damages under the contract.

In reaching its decision, the court in Williams reviewed the tribal sovereignty doctrine, noting that:

> Over the years this Court has modified these principles in cases where essential tribal relations were not involved and where the rights of Indians

> would not be jeopardized, but the basic policy ... has remained. Thus, suits by Indians against outsiders in state courts have been sanctioned ... . And state courts have been allowed to try any non-Indians who committed crimes against each other on a reservation. ... But if the crime was by or against an Indian, tribal jurisdiction or that expressly conferred on other courts by Congress has remained exclusive. ... Essentially, absent governing Acts of Congress, the question has always been whether the state action infringed on the right of Reservation Indians to make their own laws and be ruled by them.

358 U.S. at 219-220 (citations omitted).

The Williams Court went on to note that "Congress has ... acted consistently upon the assumption that the states have no power to regulate the affairs of Indians on a Reservation .... Significantly, when Congress has wished the states to exercise this power it has expressly granted them the jurisdiction which Worcester v. Georgia had denied." Id. at 220-221. The Court then concluded:

> There can be no doubt that to allow the exercise of state jurisdiction here would undermine the authority of the tribal courts over reservation affairs and hence would infringe on the right of Indians to govern themselves. It is immaterial that Respondent is not an Indian. He was on the Reservation and the transaction with an Indian took place there. ... The cases in this Court have consistently guarded the authority of Indian governments over their reservations Congress recognizes authority in the Navajos in the treaty of 1868, and has done so ever since. If this power is to be taken away from them, it is for Congress to do it.

Id. at 223 (citations omitted).

In Williams, the Supreme Court appeared to have erected in the infringement doctrine a very high barrier against state jurisdiction over Indian activities on a reservation. The assertion of state authority over a single transaction was found to infringe on the right of reservation Indians to make their own laws and be ruled by them. Extending the infringement barrier to contexts involving non-Indians more directly, however, has been a far more difficult task. Indeed, not until Crow Tribe v. Montana had any court held that a state tax infringed on tribal self-government and was invalid.

Almost twenty years elapsed after Williams before the United States Supreme Court again addressed the infringement doctrine. In Moe v.

Confederated Salish & Kootenai Tribes, 425 U.S. 463 (1976), the Court suddenly and surprisingly dismantled the infringement doctrine. In Moe, the Tribes claimed that state taxation of cigarettes sales by Indians on the Reservation infringed on tribal self-government. Relying on McClanahan v Arizona Tax Commission, 411 U.S. 164 (1973), the Court struck down the tax as applied to sales to Indians. The Tribes further argued that allowing the state to tax sales to non-Indians would result in a direct loss of revenue to, and thus constitute effective tax upon, the Indian retailer. Citing no precedent, the Court swept away the infringement doctrine:

> [T]his claim ignores the district court's finding that it is the non-Indian consumer or user who saves the tax and reaps the benefit of the tax exemption. ... Since non-payment of the tax is a misdemeanor as to the retail purchaser, the competitive advantage which the Indian seller doing business enjoys over all other cigarette dealers, within and without the Reservation, is dependant upon the extent to which the non-Indian purchaser is willing to flout his legal obligation to pay the tax. Without the simple expedient of having the retailer collect sales tax from non-Indian purchasers, it is clear that wholesale violations of the law by the latter will go virtually unchecked. ... The state's requirement that the Indian tribal seller collect a tax validly imposed on non-Indians is a minimal burden designed to avoid the likelihood that in its absence non-Indians purchasing from the tribal seller will avoid payment of a conceded lawful tax. We see nothing in this burden which frustrates tribal self government.

Id. at 481-483 (citations omitted.)

In Moe, the parties did not put to the Court any compelling proof of the loss of business that would result from either the tribal seller having to impose the state tax, or of the intrusion upon tribal government revenues resulting from the imposition of the state tax. Here, however, the Court was not likely to strain to find appropriate grounds to oust the state tax, because the tax is imposed upon persons who briefly stop in the reservation to purchase cigarettes, and the activity to be taxed did not involve reservation-generated value.

Four years after Moe, the United States Supreme Court again addressed an infringement argument in Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134 (1983). In Colville, the state tax on cigarettes sales by tribal retailers to non-Indians was held not to infringe upon tribal self-government, even where the tribe imposed a smaller tax on the same transaction, thereby resulting in multiple taxes upon sales of cigarettes on the Reservation. The Court began its analysis by stating as doctrine the ipse dixit analysis in Moe:

> Moe establishes several principles relevant to the present case. The state may sometimes impose a non discriminatory tax on non-Indian customers of Indian retailers doing business on the reservation. Such a tax may be valid even if it seriously disadvantages or eliminates the Indian retail business with non-Indians. And the state may impose at least 'minimal' burdens on the Indian retailer to aid in enforcing and collecting the tax.

Id. at 151.

In Colville, the tribes sought to prove that, because the tribes themselves tax the sales, the additional burden of the state taxes would put Indian retailers at a competitive disadvantage. In addressing this argument, the Court opined that:

> It is painfully apparent that the value marketed by the smoke shop to persons coming from outside is not generated on the Reservations by activities in which the tribes have an interest. ... What the smoke shop offers these customers, and what is not available elsewhere, is an exemption from state taxation. ... We do not believe that principles of federal Indian law, whether stated in terms of pre-emption, tribal self government, or otherwise, authorize Indian tribes thus to market an exemption from state taxation to persons who would normally do their business elsewhere.

Id. at 155 (citations omitted).

Having characterized the tribal claim so skeptically, the Colville Court then turned to the infringement question:

> Washington does not infringe on the right of Reservation Indians to "make their own laws and be ruled by them" ... merely because the result of imposing its taxes would be to deprive the tribes of revenues which they currently are receiving. The principle of tribal self-government, granted in notions of inherent sovereignty and in congressional policy, seeks an accommodation between the interests of the tribe and the federal government, on the one hand, and those of the state, on the other. ... While the tribes do have an interest in raising revenues for essential governmental programs, that interest is strongest when the revenues are derived from value generated on the Reservation by activities involving the tribe and when the taxpayer is a recipient of tribal services. The state also has a legitimate governmental interest in raising

> revenues, and that interest is likewise strongest when the tax is directed at off-Reservation value and when the taxpayer is the recipient of state services. As we have already noted, Washington's taxes are reasonably designed to prevent the tribes from marketing their tax exemptions to non-members who do not receive significant tribal services and who would otherwise purchase their cigarettes outside the Reservation.

Id. at 156-157 (citations omitted).

The only ray of hope for the infringement doctrine becoming an effective shield against dual taxation was the summary affirmance of the Crow Tribe case in 1988. In addition to its finding of pre-emption, the Ninth Circuit had held that Montana taxes as applied to coal production on the Crow Reservation were invalid because they infringed upon tribal sovereignty. With respect to the infringement doctrine, the Ninth Circuit observed:

> The self government doctrine differs from the pre-emption analysis and is an independent barrier to state regulations ... either is a sufficient basis to hold the state tax inapplicable to tribal coal ... Whether the state taxes infringe on tribal sovereignty depends on whether tribal self-government is affected ... any assertion of state authority over tribal interests must be assessed against the traditional notions of Indian sovereignty ... state action may not infringe unlawfully "on the right of Reservation Indians to make their own laws and be ruled by them." ... Tribal sovereignty contains a significant geographical component, the tribes have the power to manage the use of their territory and resources by both members and non-members. ... Taxing Indian Reservation lands or Indian income from activities carried on within the boundaries of the reservation is not permissible absent congressional consent. ... While the federal tradition of Indian immunity from state taxation is very strong, ... this Court has recognized that a state tax is not invalid merely because it deprives the tribe of revenues used to sustain itself and its programs. ... The principle of tribal self-government is to seek an accommodation between the interests of the tribes and the federal government, on one hand, and those of the state on the other. ... Montana taxes mineral resources that are a "component of the reservation land itself." ... The tax revenue from coal production could generate funds for tribal services and provide employment for tribal members.
>
> 9

> ... By taking revenue that would otherwise go towards supporting the Tribe and its programs, and by limiting the Tribe's ability to regulate the development of its coal resources, the state tax threatens Congress's overriding objective of encouraging tribal self government and economic development.
>
> ...
>
> In addition, the taxes are void for interfering with tribal self-government, a separate and independent area of state regulation of Indian affairs. The mineral estate of the ceded strip is legally part of the Crow Reservation, and taxing Indian income derived from activities conducted on Reservation property is prohibited without congressional consent. Here, Congress did not consent. Montana's interests in imposing the coal taxes do not overcome the Tribe's economic and governmental interests in coal production.

Id. at 902 - 3.

After Crow Tribe, a possible resurgence of the infringement doctrine seems possible. This doctrine becomes most important where no specific federal statutes or pervasive federal regulatory schemes apply to the activity in question. In these circumstances only the general federal statutes and policies supporting tribal economic development and self-sufficiency will be helpful in a pre-emption analysis. But the only direct and tangible result of the state tax in such circumstances may be to limit the Tribe's ability to raise governmental revenues or to maximize its proprietary income from the activity. This is a direct infringement on the ability of the Tribe to govern its own affairs.

In some respects, the infringement doctrine is superior to the doctrine of federal pre-emption. Judicial reliance on the latter doctrine, which turns on the existence of strong and pervasive federal control of tribal activities, is anomalous in light of today's federal policy supporting tribal self-determination. Thus, the infringement doctrine, along with the backdrop of the general federal statutes supporting tribal self-determination and economic development, is a needed barrier to state taxes. Under the infringement doctrine, a balancing test will be employed similar to the pre-emption balancing. Such a balancing test, however, would give great weight to tribal interests in governing the reservation by promoting economic benefit in taxing reservation activities. The resuscitation of the infringement doctrine simply must occur in light of the Court's current trend of narrowing the force of the federal pre-emption barrier.

C. Commerce Clause Limitations on State Taxation

Beginning with Warren Trading Post Co. v. Arizona Tax Commission, 380 U.S. 685 (1965), tribal advocates have sought to oust state taxes on reservations by pressing claims that such taxes are barred by the Indian Commerce Clause, Article 1, Section 8, Clause 3 of the United States Constitution. The Indian Commerce Clause provides that "Congress shall have power ... to regulate commerce ... with the Indian Tribes". In Warren, the Court reasoned "[s]ince we hold that this state tax cannot be imposed consistently with federal statutes applicable to the Indians on the Navajo Reservation, we find it unnecessary to consider whether the tax is also barred by that part of the Commerce Clause giving Congress power to regulate commerce with Indian Tribes." Id. at 686. Not until 1982 did the Court respond to a Commerce Clause-based challenge to state law in Indian country. In Merrion v. Jicarilla Apache Tribe, 455 U.S. 130 (1982), the Court upheld tribal taxes on oil and gas producer-lessees on the Jicarilla Apache Reservation. Merrion and the other producers had challenged the tribal tax on several grounds. One of those grounds was that the Interstate Commerce Clause limits the ability of the Tribe to impose its tax in that case. In response to this claim, the Supreme Court reasoned:

> [W]hen the activity taxed by the Tribe occurs entirely on tribal lands, the multiple taxation issue would arise only if a state attempted to levy a tax on the same activity which is more than the state's contact with the activity would justify. In such a circumstance, any challenge asserting that tribal and state taxes create a multiple burden on interstate commerce should be directed at the state tax which, in the absence of congressional ratification, might be invalidated by the Commerce Clause.

Id. at 158-159 n. 26. Notably, in Merrion the claim was couched as an Interstate Commerce Clause claim against a tribal tax, rather than an Indian Commerce Clause claim against a state tax. Nevertheless, the Court seemed to invite a Commerce Clause challenge to state taxation on reservations.

In 1982, in Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico, 458 U.S. 832 (1982), the Solicitor General of the United States, in an amicus brief filed in support of the Board, argued that the pre-emption analysis should be abandoned in favor of an Indian Commerce Clause analysis. The Supreme Court, however, rejected the Solicitor General's proposal, which would have required the Court:

> [T]o hold that on-Reservation activities involving a resident Tribe are presumptively beyond the reach of state law even in the absence of comprehensive regulation, thus placing the burden on the state to demonstrate that its intrusion is either condoned by Congress or justified by a compelling need to

> protect legitimate specified state interests other than the generalized desire to collect revenue. He argues that adopting this approach is preferable for several reasons: It would provide guidance to the state courts addressing these issues, thus reducing the need for a case by case review of these decisions; it would avoid tension created by focusing on the pervasiveness of federal regulation as a principle barrier to state assertions of authority when the primary goal is to encourage tribal self determination and self government; and it would place a higher burden on the state to articulate clearly its particularized interest in taxing the Tribe's action and to demonstrate the services it provides in assisting the taxed transaction. ... We do not believe it necessary to adopt this new approach - the existing pre-emption analysis governing these cases is sufficiently sensitive to many of the concerns expressed by the Solicitor General. Although clearer rules and presumptions promote the interest in simplifying litigation, our precedents announcing the scope of pre-emption analysis in this area provides sufficient guidance to state courts and also allows for more flexible consideration of federal, state, and tribal interests at issue.

Id. at 845-846.

The Court has given mixed signals as to how an Indian Commerce Clause challenge would be received. For example, Justice White's opinion in Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 157 (1980), revived some hope of such a challenge. In that case, Justice White noted:

> It can no longer be seriously argued that the Indian Commerce Clause, of its own force, automatically bars all state taxation in matters significantly touching the political and economic interests of the tribes. ... That clause may have a more limited role to play in preventing undue discrimination against or burdens on Indian Commerce. But Washington's taxes are applied in a non-discriminatory manner to all transactions within the state. ... The taxes under consideration do not burden commerce that would exist on the Reservations without respect to the tax exemptions.

Id. at 157.

Several obstacles exist to the Supreme Court employing an Indian Commerce Clause theory to limit state taxes. First, as the Court made

clear in Ramah in rejecting the Solicitor General's Commerce Clause argument, the Court wants to preserve the flexibility provided by the pre-emption analysis. The Court seems not to care that circumstances will arise in Indian country where no pervasive federal regulation exists and no specific federal statutes apply other than those embodying a general federal policy favoring tribal self-determination. In addition, the Court repeatedly has held that multiple tax burdens do not inherently conflict with the United States Constitution. As the Ninth Circuit notes in Chemehuevi Indian Tribe v. California State Board of Equalization, 800 F.2d 1446 (9th Cir. 1986):

> Nor does the existence of a multiple tax burden constitute an unconstitutional burden on Indian Commerce. ... As we stated in Fort Mohave Tribe, "there is no improper double taxation here at all, for the taxes are being imposed by two different and distinct taxing authorities. The tribe faces the same problem as other taxing agencies confront when they seek to impose a tax in an area already taxed by another entity having taxing power."

Id. at 1450.

Even if the Court were to adopt an Indian Commerce Clause theory, whether the Court would adopt the dormant interstate Commerce Clause doctrines or whether a new approach would be developed is not clear. Critical in this regard is the level of state services that the Court will find justifies the tax. Finally, if the Indian Commerce Clause theory is adopted as urged (i.e., to limit state taxes to the level of services delivered to the taxpayer), the Court does not have flexibility to deal with Colville type circumstances where Indian tax exemptions are being marketed to brief reservation visitors. Arguably, therefore, revival of the infringement doctrine is a better solution, where a balance of interests would occur, but with special weight given to tribal sovereign imperatives.

II. THE COTTON PETROLEUM DECISION

It was clear that numerous dangers existed in making the argument that the Interstate Commerce Clause barred the state taxes in the Cotton Petroleum case. First, incorporating Interstate Commerce Clause doctrines is risky in Indian cases since Commonwealth Edison Company v. Montana, 453 U.S. 609 (1981), and its progeny hold that, under the Interstate Commerce Clause, a state may impose even taxes that are far in excess of services delivered to the taxpayers, provided the state tax does not discriminate against interstate commerce, is fairly apportioned, and applies to an activity that has a substantial nexus with the taxing state. Thus, the courts will not independently determine whether the taxes are fairly related to services to the taxpayers because the imposition of state taxes are in exchange not only for direct services to the taxpayer, but also for the benefit of a civilized society provided by the state.

Because of the dangers posed by an Interstate Commerce Clause theory, many Indian advocates in Cotton Petroleum argued instead for a re-assertion of the Indian Commerce Clause. Specifically, tribal advocates argued that where no specific federal statute or pervasive regulatory scheme is in conflict with a state tax, the state tax still may be invalid under the Indian Commerce Clause if the ability of the tribe to tax and to raise revenues from that activity is diminished. The tribal advocates argued that the Interstate Commerce Clause should be employed to limit the amount of state taxes on the Reservation by requiring significant and compelling state interests to support the tax. Those interests, the tribal advocates urged, should be limited to services delivered to the taxpayers, rather than services to the Reservation in general. Any other approach would permit states to do indirectly what they cannot do directly; tax Indians for the cost of services delivered to them on the Reservation.

Indian advocates also argued that the Interstate Commerce Clause simply does not apply because of the plain meaning of the Clause set forth in many cases. The Indian advocates were not urging so high a ground as the Solicitor General did in Ramah. They simply argued that the Indian Commerce Clause should be used to limit state taxes to an amount no greater than the cost of services delivered to taxpayers. Whether the Supreme Court would address the Commerce Clause issues in Cotton Petroleum was unclear. The Court might have deferred the Indian Commerce Clause question since the case was suited for a pre-emption analysis, as pervasive federal regulations and clear federal policy embodied in statutes were at issue.

On April 25, 1989, the Supreme Court rendered its decision. In a six to three opinion, the Court held that the State of New Mexico may validly impose severance taxes upon the on-reservation production of oil and gas by a non-Indian lessee although the production is also subject to the severance taxes of the Jicarilla Apache Tribe ("Tribe"). As a result, non-Indian reservation lessees now are subject to taxes from both tribes and states on the same activity.

The Tribe is organized under the Indian Reorganization Act of 1934 and consists of approximately 2500 members. The 742,135 acre reservation is held in trust for the Tribe by the United States and was created by an Executive Order in 1887. Royalties from mineral leases constitute the primary source of revenue for the Tribe. The Tribe imposes a severance and privilege tax of six percent on all oil and gas produced on the reservation. Under the terms of certain reservation oil and gas leases, Cotton Petroleum Corporation ("Cotton") pays the Tribe a rent of $125 per acre plus a twelve and one-half percent royalty on the value of its production. New Mexico also imposes on Cotton, as well as on off-reservation producers, its state severance tax of eight percent of the value of production. Cotton paid a total of fourteen percent of production in state and tribal severance taxes as compared to the eight percent paid by off-reservation producers throughout the state. Cotton showed that New Mexico collected $2,293,953 in severance taxes from the company during 1981-1985 and spent only $89,384 providing on-reservation services to Cotton. The Tribe filed a brief amicus curiae arguing that the state tax

was pre-empted because the tax substantially interfered with the tribal tax rate and the desirability of reservation leases.

The questions before the Court were (1) whether state taxes on oil production on a reservation by a non-Indian lessee are pre-empted by the Indian Mineral Leasing Act of 1938; and (2) whether an Indian tribe to be treated as a state under the Commerce Clause for purposes of determining whether a state tax upon non-tribal activities conducted on a reservation must be apportioned to take into account tribal taxes imposed on the same activity.

A. Federal Pre-emption Analysis

Cotton argued that the New Mexico taxes were pre-empted by Indian Mineral Leasing Act of 1938 ("1938 Act"). Cotton argued that the 1938 Act reflected a strong federal interest in guaranteeing tribes the maximum return on oil and gas leases and that the imposition of a state tax unduly interfered with this federal interest. Since the Tribe and the federal government exerted comprehensive regulatory control over Cotton's reservation activities, Cotton concluded that the federal and tribal interests outweighed any interest of New Mexico.

The majority found that the 1938 Act was silent on the issue of state taxation. The majority concluded that this silence reflected an intent to permit state taxation of non-member lessees. The Court noted that, under pre-1938 Act mineral-leasing statutes, express congressional authorization was required for direct taxes on Indians and the federal government and for taxes on persons contracting with Indians or the federal government. This "intergovernmental tax immunity doctrine," however, was replaced prior to the enactment of the 1938 Act by the modern rule permitting such taxes absent congressional disapproval. Thus, the majority inferred that Congress' silence in the 1938 Act was intended to incorporate the modern rule authorizing state taxation of a non-Indian reservation lessee.

Additionally, the majority noted that when Congress enacted the Indian Oil Leasing Act of 1924 ("1924 Act"), authorizing oil and gas leasing on Executive Order reservations, Congress expressly waived the state tax immunity of lessees. Thus, the majority concluded that there is "simply no history of tribal independence from state taxation of these lessees to form a 'backdrop' against which the 1938 Act must be read." Slip op. at 17. The Court also rejected the argument that the general repealer clause contained in the 1938 Act served to bar the state taxation expressly authorized in the 1924 Act.

Finally, the majority stated that "Congress' approaches to both the 1924 and 1938 Acts were fully consistent with an intent to permit state taxation of non-member lessees." Slip op. at 18. This statement forced the Court to square this ruling with its past decision in Montana V. Blackfeet Tribe, 471 U.S. 759 (1985), where the Court held that the 1938 Act did not authorize direct state taxation of tribal royalties. The

Montana Court examined the 1938 Act and concluded "that Indian tribes, like the Federal Government itself, are exempt from direct state taxation and that this exemption is lifted only when Congress had made its intention to do so unmistakably clear.'" Slip op. at 18 n. 14, quoting Montana, 471 U.S. at 765. The majority stated the Montana decision only held that the 1938 Act did not authorize direct taxation of Indian tribes and did not involve the question of whether the 1938 Act prohibits taxation of non-members doing on-reservation business with a tribe.

The majority distinguished the case from the situations in White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980), and Ramah Navajo School Board, Inc. V. Bureau of Revenue of New Mexico, 458 U.S. 832 (1982), where state taxes were held to be pre-empted. In both cases, the Court had found that: (1) the state did not assert a legitimate regulatory interest or identify any service the state performed which justified a tax on such reservation activities; (2) the burden of the tax ultimately fell on the tribe; and (3) comprehensive federal regulations governed the details of the activity being taxed by the state. The majority stated that New Mexico provided "substantial services" to both the Tribe and Cotton. Although Cotton argued that the state services cost New Mexico only about one-third of the taxes collected by the state from Cotton, the majority refused to impose a rule that the state tax must be proportionate to the value of the services provided. The majority also ruled that no economic burden would fall on the Tribe due to the state tax and that the Tribe could, in fact, increase its taxes without adversely affecting reservation oil and gas development. Finally, the majority noted that, although federal and tribal regulations extensively governed the activities of Cotton, these regulations were not exclusive because New Mexico regulated spacing and mechanical integrity of the reservation oil wells. The majority concluded that, absent special factors like those present in White Mountain and Ramah or an unusually large state tax which imposes a substantial burden on a tribe, the 1938 Act does not pre-empt New Mexico's oil and gas severance tax. Slip op. at 21.

The Court then dealt with its affirmance of the Ninth Circuit decision in Crow Tribe that the 1938 Act did pre-empt state taxation of oil and gas production by non-Indian lessees. The Court found that it need not revisit Crow Tribe because, in that case, Montana's tax rates were an extraordinarily high 32.9% and that the taxes had a negative effect on the marketability of the Crow's coal. The Court observed that New Mexico's 8% severance tax would have only "a marginal effect on the demand for on-reservation leases, the value to the Tribe of those leases, and the ability of the Tribe to increase its tax rate." Slip op. at 22.

B. Commerce Clause Analysis

Cotton argued that New Mexico's severance taxes imposed an "unlawful multiple tax burden on interstate commerce" because the taxes were imposed without apportionment on top of the Tribe's taxes. When a single business derives income from several states, the courts apply an apportionment doctrine which provides that each state only may tax that portion of the

business' income derived from activity within its state borders. In support of its argument, Cotton relied on the following facts: (1) both New Mexico and the Tribe taxed the same activity; (2) the total tax burden to Cotton is higher than for off-reservation producers; and (3) Cotton paid taxes in amounts far greater than the value of the services it received on the reservation.

While the majority conceded that a multiple taxation issue may arise when more than one state taxes the same activity, it distinguished the present instance on the grounds that the state, the federal government, and the Tribe share geographical taxing jurisdiction over non-Indian wells located on the Jicarilla reservation. Slip op. at 24. Because New Mexico administered its severance taxes at a uniform rate and in a uniform manner both on and off the reservation, the majority concluded that neither the state nor the tribal taxes were discriminatory. The majority found that the burden of higher on-reservation taxes "is entirely attributable to the fact that the leases are located in an area where two governmental entities share jurisdiction." Id. The majority also rejected Cotton's argument that the taxes paid by reservation lessees far exceed the value of services provided by the state to the reservation, stating that:

> First, the relevant services provided by the State include those that are available to the lessees and the members of the Tribe off the reservation as well as on it. The intangible value of citizenship in an organized society is not easily measured in dollars and cents; moreover, the district court found that the actual per capita state expenditures for Jicarilla members are equal to or greater than the per capita expenditures for non-Indian citizens. ... Second, there is no constitutional requirement that the benefits received from a taxing authority by an ordinary commercial taxpayer--or by those living the community where the taxpayer is located must equal the amount of its tax obligations.

Slip op. at 25.

Cotton also argued that New Mexico's taxes have "some connection" with commerce with the Tribe sufficient to render the state tax invalid under the Commerce Clause. The majority held that this connection was insufficient. The majority stated that "[t]here is simply no evidence in the record that the tax has had an adverse effect on the Tribe's ability to attract oil and gas lessees." Slip op. at 26. The majority added that "[i]t is, of course, reasonable to infer that the existence of the state tax imposes some limit on the profitability of Indian oil and gas leases--just as it no doubt imposes a limit on the profitability of off-reservation leasing arrangements ... ." Id.

Finally, the majority ruled that an Indian tribe should not be treated as a state for purposes of determining whether a state tax must be apportioned. The Commerce Clause of the United States Constitution

provides that the "Congress shall have the power...To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes...." Because the Constitution clearly distinguishes between "states" and "Indian tribes," the Court held that tribes should not be treated as states, and apportionment is not required. Slip op. at 27-28.

Three Supreme Court Justices dissented and criticized sharply the application of the pre-emption analysis by the majority. The dissenters found that the legislative history of the 1938 Act "makes clear that Congress intended to foreclose the kind of tax New Mexico has imposed" and that the state tax also was pre-empted by the strong federal and tribal interests present. Slip op., Dissent at 1. Most significantly, perhaps, the dissenters disagreed with the majority's characterization of the adverse affects of the state taxes on the interests of the Tribe. The dissent stated that, at present levels, a producer will pay 75% higher taxes for on-reservation production than an off-reservation producer pays and that this difference may act as a deterrent to future Indian land leasing. Unlike the majority approach, the dissent would have considered not only the rate of the New Mexico tax, but also the importance of the taxed activity to tribal economy. In this case, oil and gas production is the Tribe's economy. The dissent also mentioned that the state tax may have the long-term impact of eventually limiting tribal tax revenues based on what the oil and gas market can bear. The dissent agreed with the majority that an Indian tribe should not be equated with a state under the Commerce Clause, but questioned the majority's use of traditional Commerce Clause analysis to address the apportionment question.

III. THE EFFECT OF COTTON

The impact of the Cotton decision will be to curtail the ability of Indian tribes to impose taxes, to increase existing taxes, and to market oil and gas produced on their reservations. Clearly, producers of oil and gas on reservations do not want to pay substantially higher severance taxes than their off-reservation competitors. In all instances where both a tribe and state impose an oil and gas severance tax on such a producer, however, exactly this result will occur. Thus, a state tax, as a practical matter, imposes a ceiling on tribal tax and royalty rates. Dual tribal and state taxes clearly will deter producers from entering new tribal oil and gas exploration agreements and leases. Decisions on such transactions are made on the margin, and for a producer to enter into an agreement with respect to reservation lands, the prospect will have to be demonstrably superior to off-reservation prospects to justify the additional costs of doing business on the reservation. Both new exploration and development and secondary recovery projects on producing fields will suffer.

Additionally, a diminishment of the bargaining power of tribes wishing to enter tribal-state tax compacts concerning the imposition of severance taxes on reservation oil and gas production will result, since the Cotton decision authorizes states to tax without regard for the impact on the tribe. Tribes increasingly are finding necessary the exercise

sovereign power to tax due to economic conditions in Indian country worsening because of the decline in federal funding. States soon will be faced with pleas from taxpayers and/or competition from tribes. Litigation is unpredictable and costly, making reasoned negotiations of state/tribal tax arguments more attractive. Increasing expressions of concern by taxpayers and state and tribal leaders with the tensions that result from states and tribes taxing the same activities, the extraordinary costs of litigation, the complexities of the particularized inquiry into state tax jurisdiction in each case, and the usually inadequate results of court decrees have compelled many such leaders to consider resolving such issues out of court. A few state/tribal intergovernmental agreements on taxation have been successful because they recognize appropriate state interests on the reservation, while also recognizing that the tribal and federal governments are the primary providers of services in Indian country.

For state/tribal agreements regarding taxation to be successful, several important principles must be recognized as bedrock. First, the federal and tribal governments are the main providers of a civilized society on the reservations. Accordingly, these governments must be given wide flexibility to tax on the Reservations to provide for that society. Second, the extreme poverty conditions on Indian reservations and the absence of a physical infrastructure make clear that substantial tax incentives should be accorded to the reservations in order to better achieve the important federal policies of promoting economic development and strengthening of tribal self-government. In short, extraordinary affirmative action measures will be needed by states, the federal government, and tribes to promote development on the Indian Reservations.

Third, state governments are not dependent upon revenues from a reservation, but the local county and city governments often are quite dependent on the revenues from the reservation. Accordingly, while substantial leeway exists for states to forebear on the imposition of state taxes, tribes and states must leave open the possibility that certain local taxes will be left in place, provided those taxes are not overly burdensome. In addition, states and tribes can forge important coalitions to try to seek federal tax relief so that the states properly can obtain any just due from the reservation, while at the same time the tribes are able to tax and promote the development of their Reservation economies. Finally, state and tribal tax accommodations will proceed against a backdrop of a myriad of issues that plague both the Tribes and the states. Water rights, criminal jurisdiction, law enforcement, recognition of tribal and state court decrees, social services, economic development, and many more issues can arise which will either divide the state and the tribe on tax issues or incite them all the more to work together for the common good. These facts make difficult a "boiler-plate" approach to dealing with state and tribal tax accommodations.

After Cotton, the states have little incentive to negotiate. The Rehnquist Court has departed from vigorous federal protection of the tribal tax base from undue state taxes. Thus, the tribes likely will seek

new forms of business relationships to avoid such taxes. For example, tribes may determine that tribal ownership of mineral producing operations is best advised, or that the tribe should agree to pay the lessee's share of state taxes to support findings by courts that state taxes upon mineral production on Indian lands injures federal objectives and, thus, are federally pre-empted. In short, notwithstanding the defeat in Cotton, the tribes have many cards left to play and more litigation is in the offing as tribes attempt to create a level playing field for marketing their mineral resources.

IV. PROPOSED CONGRESSIONAL POLICY INITIATIVES

A necessary backdrop to congressional consideration of solutions to the confusion wrought by the Cotton case, are a number of facts that characterize uniquely Indian reservations which deserve reemphasis here. First, by far, reservations are the most economically depressed areas of this nation. Unemployment rates in these communities typically exceed sixty percent, because the reservations suffer from over a century of wildly fluctuating federal policies. These policies ranged from termination of the existence of tribes to the present day federal support for economic and political self-determination of Indian tribes. In these circumstances, this nation can spare no effort to promote sustained development on the reservations consistent with the reservations' unique tribal cultures.

Second, non-Indians on the reservations often face tax burdens that exceed all other jurisdictions, because tribes, in addition to other federal and state entities, possess taxing jurisdiction. No parity exists, therefore, as to on- and off-reservation tax burdens.

Third, substantial evidence exists that states historically have imposed a range of often high taxes on Indian reservation activities, but have provided little, comparably, in return as services. From 1975 through 1985 on the Wind River Reservation, as an example, the State of Wyoming and its political subdivisions collected $77 million more in taxes than services delivered to the Reservation. And, all of this occurred at a time when tribal members were leaving the Reservation to purchase retail goods and services and thus paid substantial additional taxes to the state and local governments which are not counted in this figure.

Fourth, tribal taxes are a relatively recent phenomenon, with most having been enacted after the 1982 United States Supreme Court decision in Merrion v. Jicarilla Apache Tribe. This firm has assisted in the development of many of those tribal taxes and has encouraged tribes to enact relatively low tax rates, so as not to deter business from the reservations. Businesses often already are paying both federal and state taxes, and the specter of an equivalently high tribal tax very well could drive them (or keep them) from the reservation. Even today, tribal taxes typically are considerably lower than the state taxes.

Fifth, the service needs on Indian reservations are enormous, particularly as federal funds continue to decline. The pressure to raise tribal taxes, therefore, to meet these needs grows every day. Axiomatic, however, is that businesses can be taxed out of existence. Accordingly, tribes cannot raise their taxes significantly without risking the loss of its tax base.

Finally, because Indian reservations possess a unique political and legal status under federal law, many businesses are apprehensive about entering Indian reservations to conduct business. In addition, very little physical infrastructure exists to attract and support business activities on the reservations. Rare is the circumstance where businesses on an Indian reservation are there because of a unique resource which creates inherent incentives to conduct business on the reservation. More typical is the situation where business could locate either on-or off-reservation. Uniquely high tax burdens on reservations, the absence of physical infrastructure, and the uncertain legal and political environment all combine to erect significant obstacles to attracting businesses to Indian reservations.

Accordingly, critical is that the tax playing field on and off reservations be levelled. The only way to accomplish this objective is to eliminate federal or state tax burdens, which would enable tribes to impose taxes sufficient to meet the existing needs. Several options are available to Congress to achieve parity between on- and off-reservation tax burdens. Indeed, good policy arguments support an on-reservation total tax burden that is less than the total off-reservation tax burden of a particular activity. In this way, on-reservation development, as many economists will say, can be spurred.

First, Congress could eliminate state tax jurisdiction on Indian reservations. This solution obviously would be the most simple and effective way to level the tax playing field. Tribes then would levy taxes equivalent to existing tribal and state taxes to meet the staggering on-reservation service demands. Tribes also would have the flexibility not to make their taxes equal to off-reservation tax burdens, as part of tribal efforts to promote on-reservation development. Under this solution, state services to the reservations should not be allowed to abate. Federal funding to Indian reservations, coupled with tribal funding, often is expended off-reservation, where retail goods and services are available. These purchases generate ample state taxation revenues to pay for on-reservation state services.

Second, Congress could provide federal tax credits or deductions for all state taxes paid. Credits, obviously, are preferable as they achieve more directly the levelling of the tax playing field. Tax deductions, in contrast, would not achieve parity in the on- and off-reservation tax burdens, and therefore are less preferred. Also states, under this solution, would get a windfall since they now receive taxation revenues from reservation border towns where federal and tribal funds often are expended; yet they would suffer no drop in their on-reservation tax collections.

Finally, Congress could authorize a cap on state taxes imposed on Indian reservations, based upon a ceiling on the excess of state taxes over state services to the reservation. Cotton Petroleum has made unclear whether any surplus in state taxes over services, however large, is infirm under federal law. Congress needs now to assure businesses and persons on the Indian reservations that some limit to state tax burdens exists under federal law. The ratio should not exceed one dollar in state tax collectible for every dollar in state services to the reservation, in light of strong federal policies supporting reservation economic and political development.

We appreciate Congress's interest in these matters, and we urge quick action on these congressional solutions to assure existing and potential business that Indian reservations are viable places in which to conduct their business.

STATEMENT

WE ARE VERY PLEASED TO ANNOUNCE A PRELIMINARY FINDING WHICH MAY PROVIDE THE NAVAJO NATION WITH AS MUCH AS $5 MILLION DOLLARS IN ADDITIONAL TAX REVENUES.

IT IS IMPORTANT TO STATE THAT WE ARE NOT AUDITORS, NOR WERE WE SPECIFICALLY LOOKING FOR ANY SUMS AS PART OF AN AUDIT.

HOWEVER, IN THE COURSE OF OUR INVESTIGATION, THE COMMITTEE HAS DISCOVERED WHAT APPEARS TO BE AN ERROR IN THE COMPUTATION OF THE NAVAJO POSSESSORY INTEREST TAX, A TAX IMPOSED BY THE TRIBE ON OIL AND GAS COMPANIES. IN COMPUTING THE TAX OVER AN EIGHT YEAR PERIOD, THE COMPANIES MAY HAVE BEEN GIVEN AN ALLOWANCE FOR THE STATE PRODUCTION TAXES, WHICH WAS INTENDED TO, BUT DID NOT, ACCURATELY REFLECT THE PERCENTAGE OF STATE TAXES ACTUALLY PAID. AS A RESULT, THE POSSESSORY INTEREST TAX MAY HAVE BEEN LOWERED OVER THAT PERIOD IN AN AMOUNT WHICH COULD REACH $5 MILLION DOLLARS. ADDITIONALLY, CORRECTION OF THE ERROR WOULD YIELD SIGNIFICANT ADDITIONAL TAX PROCEEDS IN THE FUTURE.

LET ME MAKE CLEAR THAT WE HAVE FOUND NO EVIDENCE THAT THE OIL COMPANIES THEMSELVES INTENTIONALLY MISSTATED THE AMOUNT OF TAXES PAID, OR EVEN THAT THE OIL COMPANIES WERE THE SOURCE OF THE POSSIBLE MISINFORMATION.

WE HAVE RECENTLY ALERTED THE TRIBE TO THIS PRELIMINARY FINDING AND HAVE COMMITTED TO WORK WITH THEM TO HELP THEM COLLECTION ANY TAXES OWED. WE ARE DELIGHTED TO HAVE FOUND ADDITIONAL FUNDS FOR THE NAVAJO NATION.

○